

**eBook**

# HSC Business Studies 101

David Broadbridge  
Warren Dobs

OPERATIONS

FINANCE

MARKETING

HUMAN RESOURCES



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# HSC Business Studies 101

David Broadbridge |

Warren Dobs |



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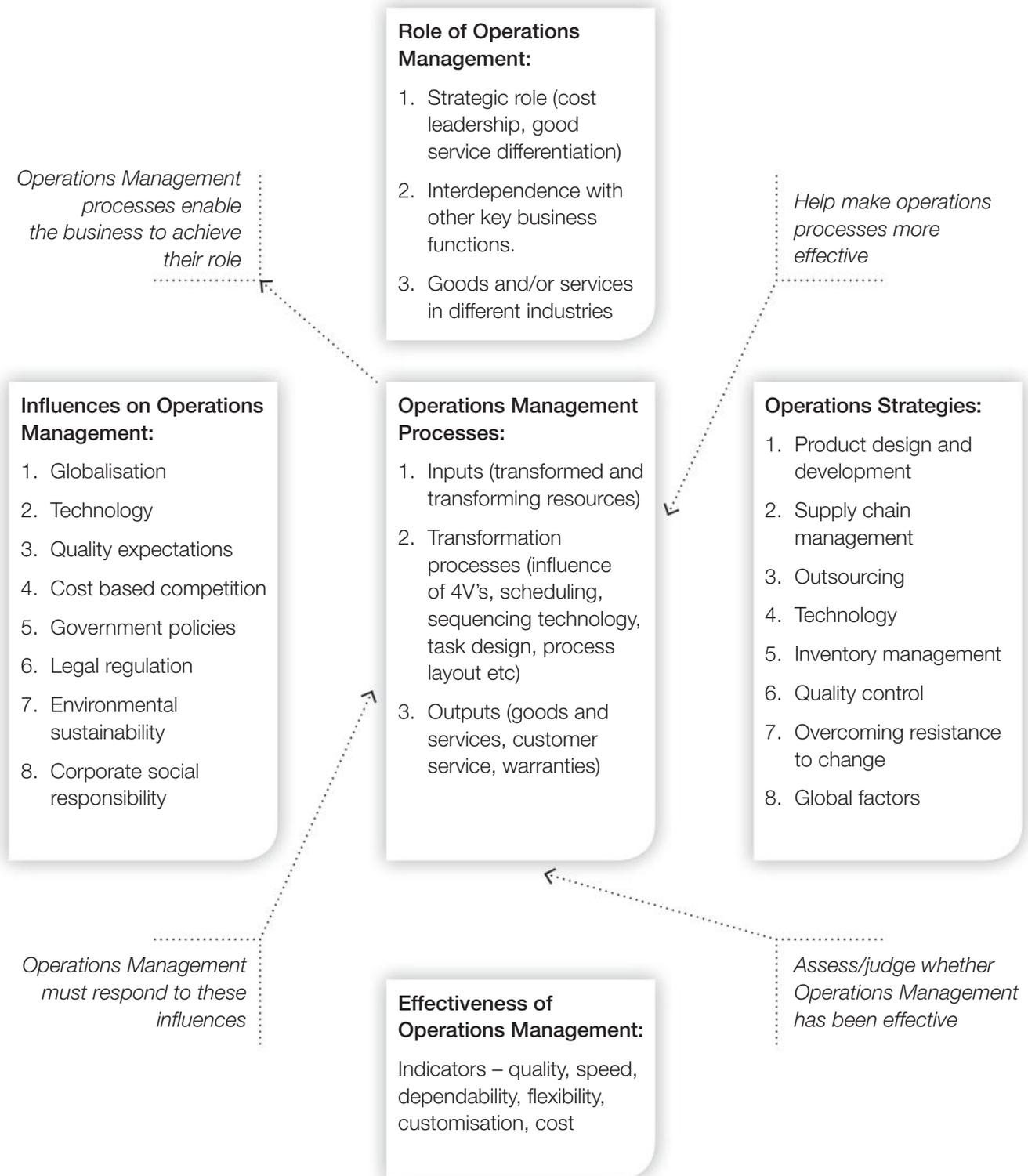
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# Chapter 1

## OPERATIONS



## 1. The Role of Operations Management

### a) The strategic role of operations management

The strategic role of operations management is the long-term decisions regarding the operations of the business to enable the business to maximise profits.

- The strategic goals aim to improve **productivity, efficiency** and the **quality** of outputs.
- Operations management is about how businesses produce goods and services.
- Operations management can either make or break any business.
- It's the engine room of the business.
- It's about how businesses get things done (day to day activities of the business).
- It helps transform inputs (labour, raw materials, capital, entrepreneurship) into outputs (goods and services).
- It's really strategic because it affects all key business areas. (This is LONG-TERM)

### b) Cost Leadership approach

Involves aiming to have the lowest costs or to be the most price-competitive in the market. It is the competitive advantage a business holds over its rivals by having the lowest production cost. A key aspect to cost leadership is that although trading with the lowest cost, the overall business should still be profitable.

To gain cost leadership, operations management must find ways to minimise costs. A number of methods are available:

- Economies of Scale. These are minimisations of cost because of the size of the business (savings of size). The bigger the business, the more 'purchasing power' it can exert in obtaining its inputs and it gains efficiencies from the improved use of technology. Fixed costs can be spread over more units which will drop the total cost per unit.
- Standardisation. The more uniform (same) the product or service production costs per unit is lower (due to increased speed).
- Technology. The adoption and application of advances in technology directly impact on production costs, most commonly through the reduction in labour costs and a more efficient operations process.
- Waste Minimisation. Minimising waste will result in lower production costs. 'Waste' can take the form of excess production, under utilisation of labour or equipment, faulty or defective production and excess inventory.

## Case Study IKEA

IKEA is the world's most successful furniture retailer. Innovations in operations reducing its costs has given IKEA a competitive advantage over their rivals. These cost leadership innovations include:

- Long term relationships with suppliers
- High volume of ordering
- Pieces are designed to include minimal parts
- Flat packaging allows lower shipping costs
- New materials are created like their particle board which weighs less reducing transport costs
- All furniture carries a ticket and customers are asked to pick up their furniture from the warehouse
- Customers do their own delivery and assembly

### c) Differentiation of Product/Service approach

This approach does not mean competing based on cost like cost leadership approach but by adding features to differentiate its product/service from its competitors. Different ways a business can differentiate its product are:

- Higher quality/better performance
- Added value/more customer support
- Convenience
- Trust/respected image/conscience
- Faster delivery
- Custom-designed products
- More features and applications
- Incorporation of new technology

#### d) Goods and or services in different industries

Operations are shaped by the range and types of goods and services they produce.

Goods are a physical product that you can see, touch, consume. Services are activities/tasks performed by a business for a customer.

Goods (manufacturing) and Services share many similarities – they are driven by consumer wants, they can be standardised or customised, they are created by using people and technology etc

However, there are differences which impact on operations (make operations different).

- Goods are tangible. Services are intangible. Goods are consumed, services are experienced. Goods can be perishable or non-perishable. The manufacturing of goods can use more automotive technology. Services rely more on information-based technology. Also goods need to be located close to raw materials, labour etc. For services more emphasis is on being close to customers.
- Demand for services is more difficult to predict. Services cannot be stored and therefore, cannot use physical inventory as a buffer for fluctuations in demand.
- Goods and services require different operational HR skills. Goods require more technical skills. Services require service management skills.
- Services require that the customer be present therefore Operations is designed for customer interaction. Goods facilities are designed purely for efficiency because the customer is not present.

#### e) Interdependence with Other Key Business Functions

- **Interdependence** refers to the mutual reliance that the key functions have on one another.
- The key business functions work best when they overlap, and employees work towards common goals.
- Each function area depends on the support of the others if it is to perform at capacity.

Because of its central role, operations must be performed in coordination with other business activities. Human resources, finance and marketing exist because of and to support the operations function. However, operations cannot succeed without their contribution to and direct participation in the transformation of inputs into the final outputs.

- Operations uses human capital (people) as a major input. Operations communicate to Human Resources its human resource needs. In turn Human Resources recruits, trains and helps retain the operational staff. Operations relies on Human Resources to provide it with

the necessary skilled staff to perform the operations function. Human Resources relies on operations to indicate what Human Resources are needed for the operations function.

- The finance function monitors, records, and analyses the financial transactions. It provides regular and periodic reports on the financial performance to enable operational management decisions. Also operational activities rely on funds.
- The marketing function connects operations with the customer by providing market requirements. Operations in turn affects marketing decisions by determining the capabilities and constraints in pricing and product design of operational processes. Operations provides the good or service that the marketing function markets. Marketing markets the goods or services provided by operations creating a demand for the business's product or service.

### Exercise 1.1

Indicate whether the following statements is true or false.

True / False Questions	True / False
1. Operations usually employ most of the business labour.	
2. Standardisation means giving customers more options.	
3. Good are intangible.	
4. Marketing and operations work together to determine product	
5. Demand for goods is more difficult to predict than services.	

## 2. Influences on Operations Management

The business environment has a significant impact on operations management. These influences/challenges require operational responses.

- Influences on operations have a dual effect on businesses.
- First, it can cause the business to undergo change and to continually adjust to external factors. Responsiveness to change is a constant issue for business.
- A second affect is the threat and the opportunity that these influences represent to operations processes.

## a) Globalisation

Globalisation means a woven world; one that is more integrated, more interrelated.

It is the worldwide movement toward economic, financial, trade, and communications integration. It is characterised by an increasing integration between national economies and a transfer of capital, labour, intellectual capital and ideas, financial resources and technology.

Globalisation has a big influence on operations management:

Globalisation has impacted on outputs. It enables businesses to access new markets overseas (provides a source of market opportunities). Big businesses are increasingly looking to target the global market and meet the needs of global (uniform/same) consumers. Apple is a great example of this because they produce standardised products, in large scale production plants, gaining economies of scale to target global consumers.

Globalisation has impacted on inputs enabling businesses to source inputs (**materials** and **labour**) at a lower cost. This results in a network of suppliers around the world. This is called a global web. Apple is again a great example because most of its products have been made by other businesses overseas enabling Apple to mass produce innovative products at low costs.

## b) Technology

Technology is the collection of techniques, skills, methods, and processes used in the production of goods or services. Technology can be seen to be a range of enabling and improving processes.

Technology (machines, equipment and devices that create/deliver the goods and services) play a big role in operations. Technology is pervasive in all types of operations. Advances in technology have radically changed many operations.

Examples of operational technology include things like:

- Sophisticated and automated factories
- Computer systems that run accounting systems and stock control systems
- Computer controlled machine tools
- Robots
- Information technology (internet, intranet, extranet)

Technology can improve operational performance by affecting:

- Quality (being right)
- Speed (being fast)
- Dependability (being on time)
- Flexibility (being able to change)
- Customisation (being able to provide more options)
- Cost (being productive)

Operational managers must understand new technology – what it can do, advantages it can bring, constraints (cost, need for retraining, downsizing) it might impose.

### c) Quality Expectations

Customers will make purchase decisions on an expectation of quality. Customers today have higher quality expectations. This influences operations by creating constant pressure to ensure customer expectations are fully met, and if possible, to be exceeded. It determines the way products and services are designed, created and delivered to customers.

Quality expectations for goods include:

- Quality of design (meeting customer needs, type of materials, innovation)
- Fitness of purpose / how easy it is to use
- Durability (reliability, ease of maintenance)

Quality expectations for services include:

- Professionalism of the service provider, courtesy of staff
- Reliability of service provider / efficiency
- Level of customisation / meets needs of consumers

### d) Cost-based Competition

This is the actions of competitors and how they price their products.

Competitors actions influence operations by impacting on their market share and profitability. Cost structures and pricing policies of competitors have a big impact on operations. This has meant an ongoing focus on cost minimisation (cost leadership) for many businesses.

Effects on operations management includes: introduced technology (automated production), outsourcing, strategic alliances, restructuring (downsizing), economies of scale, sourcing cheaper inputs from overseas.

### e) Government Policies

All businesses operating in Australia are subject to policies applied by three levels of government – Local, State or Territory and Federal. Government policies have a big impact on operations.

For example, their economic policies (monetary, fiscal policy etc.) have a direct impact on the level of economic activity and therefore the demand for its products/services.

### f) Legal Regulation

Because operations involve labour, technology, energy (environment), finance etc. there are numerous regulations (laws of business). To remain in operation, a business must comply with these regulations. The range of laws with which a business must comply are collectively termed 'compliance'.

Compliance costs are the expenses associated with meeting the requirements of legal regulations, i.e. abiding by all laws.

Penalties for non-compliance are severe.

Examples are:

- Fair Work Australia (Fair Work Act 2009)
- Carbon tax (since been repealed)
- Work Health and Safety (Work Health and Safety Act 2011)
- Environmental protection (Protection of the Environment Operations Act 1997)
- Anti-Discrimination (Anti-Discrimination Act 1977)
- Workers Compensation (Workers Compensation Act 1987)

### g) Environmental Sustainability

Environmental sustainability means that business operations should be shaped around practices that consume resources today without compromising access to those resources for future generations.

Growing public concern and awareness about the negative effects of business operations on the environment has put pressure on business to adopt environmentally sustainable practices.

For example

- Conserve non- renewable resources
- Reduce waste
- Recycling
- Reduce the carbon footprint

Environmental sustainability impacts operations by

- Law (Environmental protection laws/carbon tax)
- Being part of their ethical/social responsibility
- Impacting on consumer demand as they want environmentally friendly products
- Affecting inputs like the move to more renewable sources e.g. solar energy
- Affecting outputs that are more environmentally friendly e.g. Toyota Prius

### Case Study Tesla Motors



The International Energy Agency Report states that the transport sector causes 21% of total greenhouse gas emissions, within which the road transport sector accounts for 15%. The pollution released from conventional vehicles is not only detrimental to the environment but also to human health.

Tesla Motors is a renowned manufacturer of electric vehicles, solar panels and batteries for cars and home electricity storage. The company emphasises clean energy generation and has designed the first all-electric sedan. Tesla was founded by engineers Marc Tarpenning and Martin Eberhard in 2003. Elon Musk joined the company later in 2004.

A recent study found that the Tesla Model 3 emits 91 grams of CO<sub>2</sub> equivalent per kilometre, which is 65% less than the 260 grams of a equivalent Mercedes. In addition, Tesla's production plants are more sustainable by making use of high technology robots and the latest machinery. The plants are also designed to function on renewable energy.

## h) Ethical and Social Responsibility (Corporate and Social Responsibility)

Corporate social responsibility is open and accountable business action based on respect for people, the community and the environment.

Operations managers have to balance being economically viable yet socially responsible. Corporate social responsibility is about how business takes account of its economic, social and environmental impacts in the way it operates – maximising the benefits and minimising the downsides. It is the voluntary actions that business can take over and above compliance with the law. CSR permeates almost every decision taken by the operations manager.

It involves doing more than just complying with the laws and regulations.

The difference between legal compliance and ethical responsibility:

- Ethics is more than merely complying with the law.
- Ethical behaviour involves making decisions that are not only legally correct but also morally correct.
- To show commitment to ethical behaviour businesses will develop, implement and publish a code of conduct which could include:
  - Supporting charities and local communities
  - Promoting human and civil rights in Australia and overseas
  - Consultation of the community prior to a significant change to the business.

Economic growth should not occur at the expense of polluting and degrading the environment.

There must be a balance between economic and environmental concerns

Being socially responsible involves:

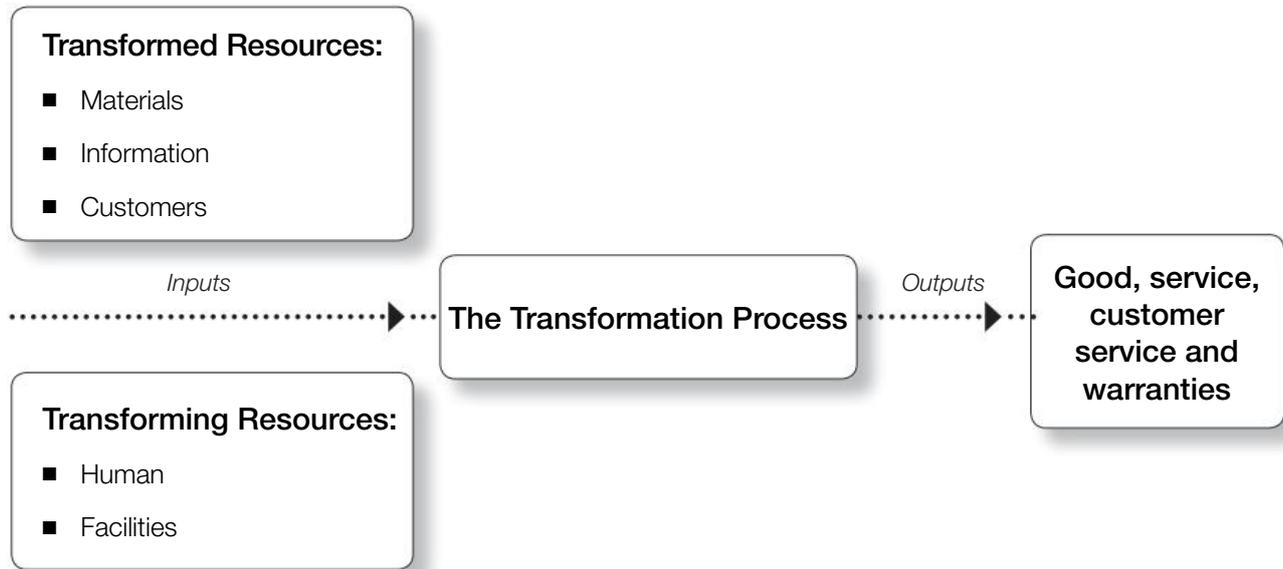
- Taking actions or making decisions that are morally and ethically correct and are in the best interests of the community.
- Issues such as noise levels, waste management and pollution.

If a business is not seen to be socially or environmentally responsible its reputation and profitability may suffer.

### 3. Operations Processes

Operations produces goods and services by changing inputs into outputs using an input-transformation – output process. Operations are processes that take a set of input resources which are used to transform something or are transformed themselves, into outputs of goods and services.

**Figure 1 Input – Transformation – Output Processes**



Operations processes are those processes involved directly with transformation of inputs into outputs.

The processes may be broadly classified according to their role in transformation:

- Inputs into transformation processes
- The actual processes or transformation
- Outputs of the transformation process

#### a) Inputs

Inputs are the resources used in the transformation (production) process. Inputs are classified as:

##### 1. *Transformed Resources*

These are the resources which are treated, transformed or converted (changed) by the operations processes. The main transformed resources are:

- **Materials.** Operations process materials. Manufacturing changes their physical shape, Australia post changes their location and retailers change their possessions. Some of these materials are raw or intermediate goods e.g. coffee beans in a café.

- Information. Operations process information. e.g. accountants transform informational properties, market research companies sell information, telecommunication companies change the location of information
- Customers. Operations process customers. The customer becomes a transformed resource as the outcome of utilising the output of the business. e.g. Hairdressers change the physical appearance of customers, airlines transform location of customers, hotels store customers. Customers are also an input because it is their needs and desires that 'drive' the operations of the business; their choices shape additional inputs and processes.

## 2. Transforming Resources

These are the resources which effect the changes in the operations process. They cause the transformed resources to be changed. They carry out the transformation process. They include;

- Human Resources (Labour/Staff). The people who operate, maintain, plan and manage the operations
- Facilities (Capital). The buildings, equipment, plant and process technology

### b) Transformation Processes

A business must determine how it will produce its goods and/or services.

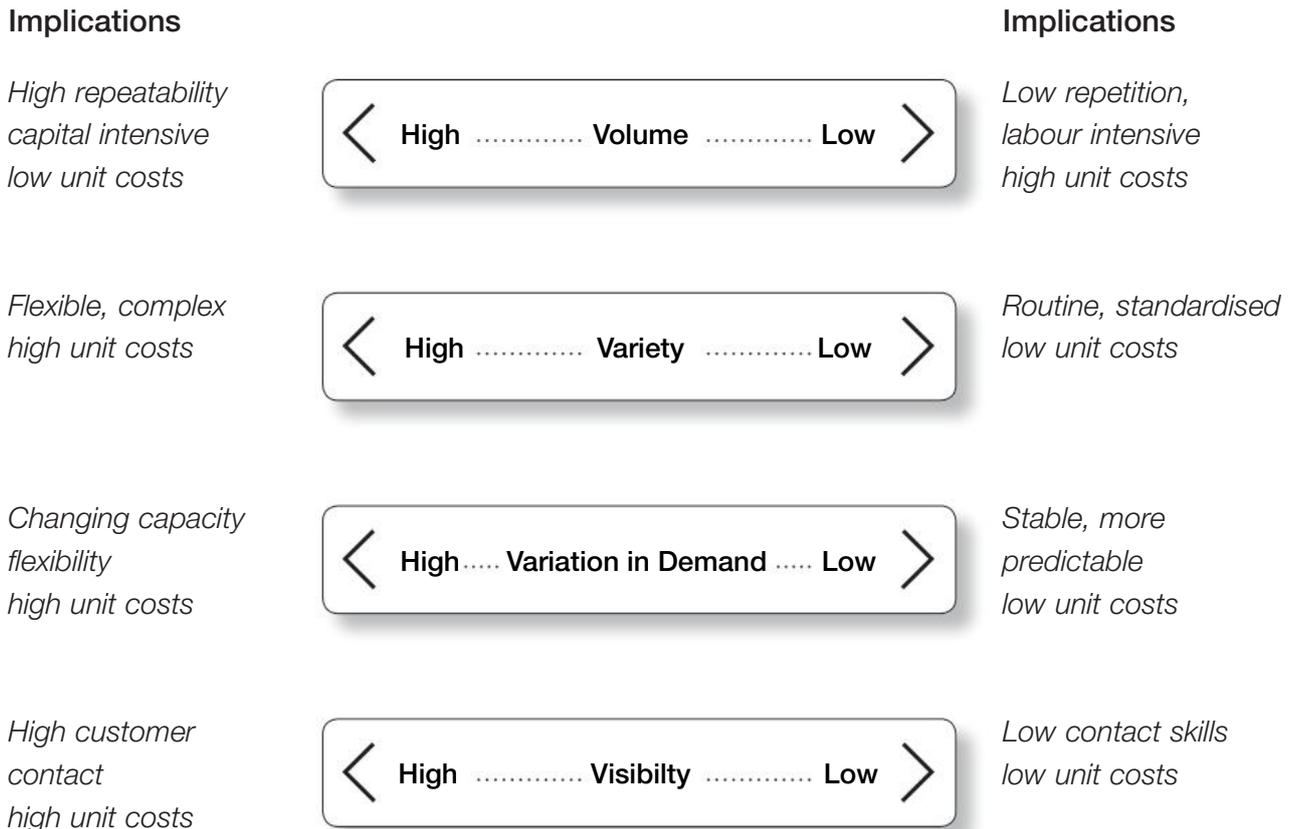
#### 1. The influence of Volume, Variety, Variation in Demand and Visibility

Operational processes must be focused on how much or what quantity of output to produce. The transformation processes to satisfy that requirement will be influenced by factors known as the 'Four V's'.

- V1 – Volume. How much output is made? High volume businesses usually produce more standardised products which require basic repetitive labour skills; low volume ones usually produce more customised product which require more specialised labour skills.  
e.g. McDonalds V Greedy Goat (small café)  
McDonalds – repeatability of tasks, systemisation, specialised equipment, so lower per unit costs.
- V2 – Variety. The mix or range of outputs produced. The more variations there are the more complex is the transformation process. The greater the variety, the more flexible the transformation process needs to be and the more expensive and time consuming it will be.  
e.g. Taxi service V Bus Company  
Taxi – higher variety, more flexible, more customised, more expensive.

- V3 – Variation in Demand. How operational processes respond to changes in demand. Seasonal changes can cause wide variations in demand. Unit costs can be higher with a high variable demand pattern.  
e.g. Hotel- summer peak, hire more staff, higher overtime costs
- V4 – Visibility. How much of the process does the customer experience? Service industries have high visibility while manufacturing ones have low visibility, low contact skills and lower costs.

**Figure 2 Implications of 4V's on Operations Processes**



Source: Operations Management by Slack, Chambers and Johnston

## 2. Sequencing and Scheduling

Sequencing and scheduling assist with structuring and the order of the transformation process.

They are used to identify all steps (called task analysis) required for the operations process and organise them into the most efficient order.

Sequencing is the order in which tasks must be performed. The priorities given to work in operations are often determined by a predefined set of rules.

e.g. Accident Emergency patients who arrive with serious injuries are treated first, non-urgent cases can wait hours until the urgent cases are treated.

Scheduling accounts for the time duration each of these tasks must take for completion. The length of time activities takes.

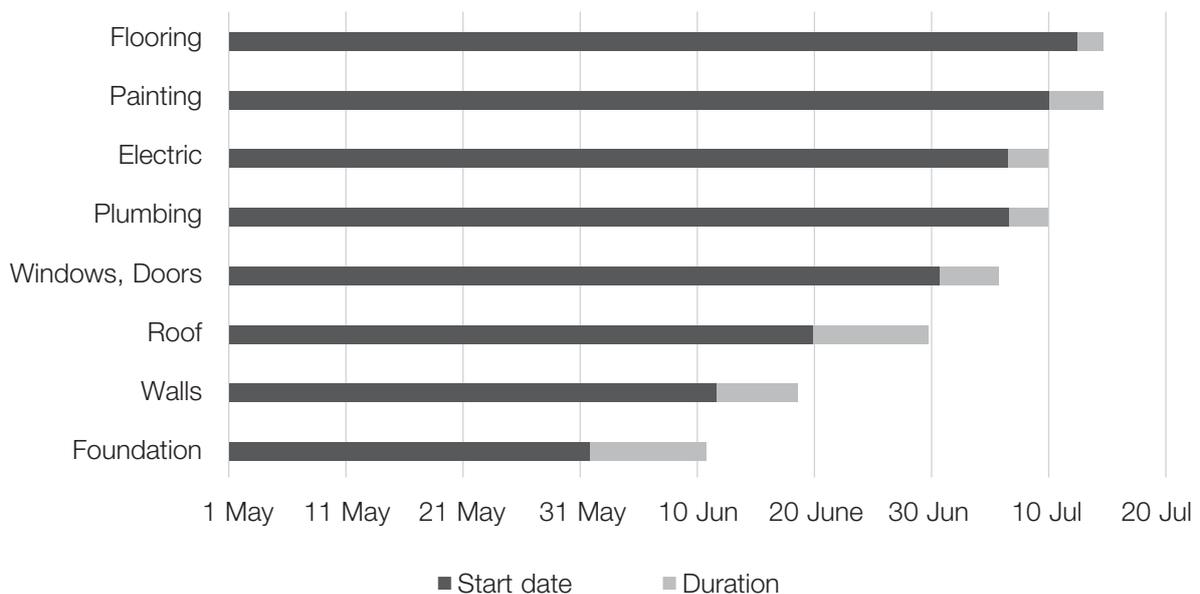
It is a detailed timetable showing at what time or date jobs should start and end.

e.g. Bus schedule shows the time each bus is due to arrive at each stage of the route. It also shows more buses are put on routes at more frequent intervals during peak hour.

2 scheduling techniques:

- GANTT CHARTS – Bar Chart that illustrates a project schedule (start and finish dates)

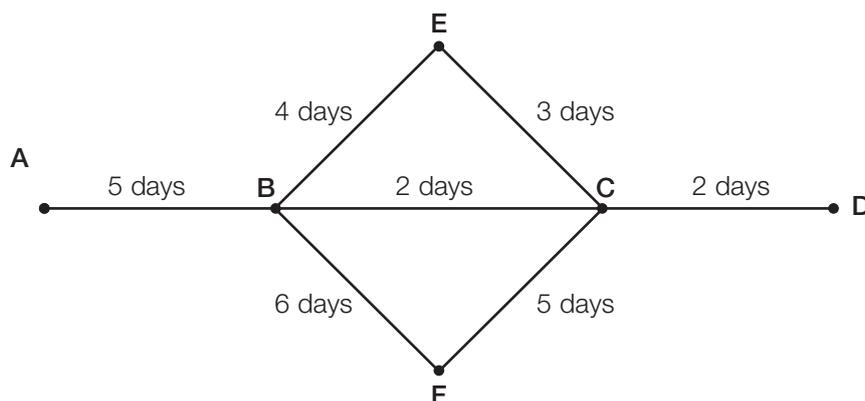
Figure 3 GANTT chart



- Critical Path Analysis – A project-management technique that lays out all the activities needed to complete a task, the time it will take to complete each activity and the relationships between the activities.

CPA enables the business to determine the critical path. The “critical path” is the shortest length of time it takes to complete all tasks.

Figure 4 CPA



### 3. Technology, Task Design, Plant Layout and Process Layout

#### Technology

- Is the use of machines/systems that enable businesses to be more efficient/effective/productive.
- Businesses are under pressure to continually update technology (which is expensive).
- Businesses also need to factor in retraining and the cost of redundancy.

The capital cost of technology is often high; therefore businesses must decide if they are going to purchase or lease it.

Examples of technology impacting on operations:

- Office – blackberries, laptops, iPad, wireless etc. (telecommuting)
- Manufacturing – Robotics (programmable machines capable of doing several different tasks that would have been done by people), CAD (is computer technology that allows architects, engineers and designers to draw and adjust three-dimensional designs using a computer), CAM (Is the software that controls manufacturing processes – it is directly related to CAD).

Developments in office technology have created the opportunity for people to do more work in less time. Therefore a greater range of tasks can be completed in their working time. This technology has also enabled employees to work from home or while away from the office. These virtual offices are known as ‘telecommuting’.

#### Task Design

Task Design is the breaking down of the operations process into the individual tasks to be performed. It's done in conjunction with HR. It determines the number of operative staff that will be required, the skills they need, whether training or retraining is necessary and, if required, the recruitment of additional or more specialised staff. It overlaps job analysis (an HR responsibility) because as the operations manager must ask “what needs to be done?” In achieving business goals task design is breaking down the work into a series of jobs in which each contributes to the final goal.

#### Plant (Product) Layout

Plant (Product) Layout is the arrangement of equipment, machinery and staff and can have a major impact on efficiency. Product layout is where the equipment arrangement relates to the sequence of tasks performed in manufacturing a product. Work stations are arranged to match the sequence of operations, and work flows from station to station. Product layout would tend to suit a business who is involved in mass production. e.g. McDonalds

## Process Layout

Process Layout is where machines and equipment are grouped together by function. Process layout requires staff to be specialised and know how to use the equipment and tools in their department. A hospital will be use process layout – for example: there are areas dedicated to particular types of medical care, such as maternity wards and intensive care units etc. This layout is associated more with batch production or specialised goods. This deals with more high variety, low volume production. In the process each product has a different sequence of production. e.g. Hospital

## Office Layout

The organisation of offices to ensure work is performed efficiently.

## 4. Monitoring, Controlling and Improvement

Having created a plan for the operations through sequencing and scheduling, each part of operations has to be monitored and controlled to ensure that planned activities are happening and to focus on continuous improvement.

Monitoring involves detecting what is happening with all aspects of operations, measuring actual performance.

Control involves assessing operations against planned performance (performance targets) and making corrective action (changes) if required.

Improvement refers to the systematic reduction of inefficiencies and wastage, poor work processes and the elimination of bottlenecks.

### c) Outputs

This is the final good or service delivered to the customer. Most operations produce a mixture of the two.

There are other subtler outputs such as customer service and warranties. They imply that the inputs and processes are subject to scrutiny by consumers. They can help a business adjust their transformation process, so they can become more effective.

#### 1. Customer Service

Customer service refers to how well the service meets or exceeds the needs of its customers.

If a customer expresses dissatisfaction with a product because it is defective, not meeting quality expectations, finds wait times/lead times too long or returns the product or makes a warranty claim, then the operations processes need review.

Research has shown that one dissatisfied customer usually tells 11 others, who in turn will tell another five.

## 2. Warranties

Warranties are an agreement to fix defects in products. A good way to assess the effectiveness of operations processes is to measure the number of warranty claims. The number of claims made against a business on a particular product line or product range will give an indication of problems in the processing.

The *Fair Trading Act (NSW)* and the *Competition and Consumer Act 2010* stipulate all businesses must ensure that the goods they sell:

- Have a level of quality comparable to the price and description
- Are suitable for the purpose or job they will be used for
- Match the product description in any advert or promotion
- Are free from defects or faults.

### Exercise 1.2 Matching

Match the following statements with the correct terms below.

1. Having a network of suppliers around the world	
2. The expenses associated with meeting the requirements of legal regulations	
3. Open and accountable business actions based on respect for people, the community and the environment	
4. The collection of techniques, skills, methods and processes used in the production of goods and services	
5. A woven world, one which is more integrated and interrelated	

**Word Bank:** Globalisation, Corporate social responsibility, Global Web, Compliance cost, technology

## 4. Operations Strategies

To achieve operations goals and broader business goals, operations managers can apply numerous operations strategies. All strategies relate to activities involved in the production of a good or the provision of a service. An effective operations strategy will give a business a competitive advantage.

There are a number of strategies for improving operations.

### a) New Product/Service Design and Development

Why is the creation or development of new products and services an important strategy for operations? What are the implications if a business chooses this operation strategy?

Business need to develop new products (or services) to grow and attain a competitive advantage. Apple is a great example.

New product development processes include:

- Concept development
- Cost benefit analysis
- Production design
- Product testing

A combination of the following approaches to product design & development work best:

Consumer approach – ascertain customer preferences through market research to determine product features and quality.

Capability approach – changes in technology allow for advanced product functionality.

Other considerations:

- Supply chain – can suppliers provide the materials and in a timely fashion to meet design needs?
- Quality – do the materials exist to meet the needs of customers?
- Capacity – are manufacturing resources able to facilitate development while meeting current production requirements?
- Cost - will the costs involved add justifiable value to the good that sales will cover the R&D process?

## b) Supply Chain Management (SCM)

All businesses need suppliers. Supply chain management refers to controlling the flow of supplies through the whole operations process from sourcing the raw materials like fuel to final delivery to the customer. The intention is to achieve efficient and cost effective production through reduced inventory in particular, increased transaction speed and increased customer satisfaction. Inventory is a major expense in the operations process. Suppliers need to be found that can provide the most appropriate inputs at the best price and reliably supply the required quantity with appropriate quality.

Many businesses have rationalised their suppliers (reducing the number). This reduces admin headaches which could cause delays and allows the business to improve its relationship with a few key suppliers. Relying too heavily on individual suppliers may make the supply chain vulnerable to delays.

It is vital that the business knows the lead time involved for each supplier.

The lead time is the time it takes for a supplier to provide its customer with the goods ordered.

The shorter the lead time, the more flexible purchasing becomes, which will allow for a greater adaptability in production.

Using SCM as an operational strategy involves four key components:

- **Sourcing.** Sourcing (procurement) refers to the purchasing of inputs for the transformation processes. This is basically the purchasing function. A business must forecast its quantity and quality requirement of every input needed in the operations process. Potential suppliers must be assessed for dependability and flexibility.
- **Global sourcing.** Modern operations involve increasing levels of global sourcing – obtaining supplies without being constrained to local sources. This has advantages because the materials might be cheaper elsewhere, or not available in Australia, lead times might be shorter. There are some risks involved because of changing exchange rates laws and customs which apply in other countries.
- **E-commerce.** This is simply buying and selling on the internet. This technology has had a major impact on SCM. Most businesses manage their supply chain online. That is, they link changes in stock levels with the placement of orders with suppliers. It also provides for payment through electronic funds transfers.
- **Logistics.** Basically refers to distribution – getting goods or services to the customer. It includes transportation (physical movement – road, train, sea, air etc.), warehousing (place for holding stock), storage (secure place to hold stock) and materials handling and packaging.

- Air transport is fast but expensive
- Sea transport is cheap but slow (also limited in destinations)
- Rail is good for bulky items like coal
- Road is great because its door to door

### c) Outsourcing

Outsourcing is the use of external providers to perform business activities. A decision to outsource is based on the expectation that this will be cheaper and more efficient than performing the task in-house. Having made that assessment, management must seek and select suitable suppliers and their location, and develop contracts for supply which include critical KPI's on quantity, quality, timeliness, dependability, flexibility and cost. The opposite of outsourcing is vertical integration in which the business performs ALL the tasks and makes all the inputs in-house with no external contribution.

#### *Advantages of Outsourcing*

In using outsourcing as an operational strategy the advantages can be significant:

- Saving in capital outlay – factory space and machinery are provided by another business at their expense;
- Saving in labour – staff management and expenses are born by the other business;
- Increased dependability – more than one external supplier can be accessed, thus ensuring security of supply;
- Saving in cost – the other business can provide the input at a lower price than it can be done in-house;
- Access to higher level skills – the other business contains skills that do not exist in-house;
- Increased flexibility – variations in demand are managed by the other business.
- Saving in management – Having set up the contracts, management can concentrate only on the tasks it does perform in-house.

#### *Disadvantages of Outsourcing*

There are, however, issues which need to be balanced against the advantages:

- Dependency – the operations process is now dependent on another party for supply of inputs; failures in that external supply chain can cause major internal disruption and expense;

- Loss of control and security – there can be a loss in control of standards and vulnerability to proprietary and patent data and information accessible by the supplier;
- Quality – control is no longer exercised over the inputs used by the outsourced supplier;
- False economy – outsourced inputs can become more expensive over time so constant review of the decision is warranted;
- Cost – the one-off expense of redundancies to staff no longer required is an offset to the savings from outsourcing;
- Industrial problems – can arise from down-sizing as an outcome of the outsourcing.
- Damage to public image – as a result of publicity about jobs going offshore.

#### d) Technology

Businesses all rely heavily on technology. It's a way of obtaining a competitive advantage. There are two broad categories:

##### (1) *Leading edge.*

This is technology still undergoing development and at the very forefront of research (newest, most state of the art version). The rewards for successfully integrating it into the business can be very significant in terms of competitive advantage and market share and premium prices for the product (higher revenue and profit). It can be a big marketing selling point. High rewards also attract high risks and costs (unforeseen bugs and uncertainty).

##### (2) *Established technology*

This is technology already well stabilised, well serviced, widely used and proven in the market place. These are all sound tested applications which attract virtually no risk to the operations process. Because of their universal availability established technologies may not confer competitive advantage, but the absence of their use may well result in competitive disadvantage.

NB Choosing the level of technology employed and the timing of its adoption is a key operational management decision; going too early has high risk, going too late can mean customers are lost.

#### e) Inventory Management

Inventory refers to raw materials, work in progress (unfinished goods still undergoing the transformation process) and finished goods held by the business at a point in time. The extent of these holdings is an important operational strategic decision, because they represent significant capital outlay (cost) which is yet to yield revenue. Obviously it is desirable to

hold only that amount essential for the smooth, efficient operation of the business. To hold excess quantities imposes additional cost on production, but to hold too little can result in disruption to production and loss of sales because customer demand cannot be met. Inventory management is the system that manages the ordering, storage and recovery of the material inputs used in production.

### *Advantage of holding stocks*

- Help ensure operations run smoothly
- Allows a business to respond to changes in demand
- Allows greater potential for customisation
- Can reduce costs if they can buy their materials more cheaply in bulk

### *Disadvantage of holding stocks*

- Stocks have to be stored – storage space costs money
- Stock must be insured
- Stocks tie up resources (working capital)
- Risk that stocks will become spoiled, outdated or obsolete over time

JIT (just in time) is a method of inventory control whereby stock levels are kept very low by only producing goods when they are demanded and therefore only getting supplies when they are needed. Coca Cola Amatil bottling plant at Northmead is a great example.

### *Advantages of JIT*

- Avoids all disadvantages of holding stock – storage costs, wasted working capital etc.
- Allows business to respond precisely to market demand
- Forces the transformation process to become more efficient

### *What stock would you use first?*

- LIFO – most recent stock is used first (LAST STOCK IN is the FIRST STOCK OUT)
- FIFO – oldest stock is used first (FIRST STOCK IN is the FIRST STOCK OUT)

Most use FIFO because it minimises the final products being more difficult to sell.

### *How do you value stock?*

The value of stock will affect the Cost of Goods Sold (COGS) and therefore profit.

- LIFO – value the stock at a higher level because it assumes that the last goods purchased are also the first goods sold and therefore the cost of each unit sold is the last cost recorded. Bigger tax deduction lower paper profits.
- FIFO – cost of each unit sold is the first cost recorded because it assumes that the first goods purchased are the first goods sold.

ATO does not allow the valuing of stock based on LIFO for tax purposes as this overstates the cost of stock and drops the profits which would reduce its taxes. Businesses must use FIFO or a WAC (weighted average cost).

### **g) Quality Management**

This operations strategy involves the processes applied to maintain consistency, reliability and suitability of the output. Quality is measured by the customer in relation to the extent the product meets or exceeds their expectation. Customer satisfaction enhances the prospect of future orders and favourable customer recommendation to friends. Higher quality usually means higher price, so a business must strike a balance between the two and strive to maintain the desired optimum quality outcome.

Approaches to achieving Quality are:

- **Quality control (QC)**  
Programmed inspections are carried out at key stages (on a continuing basis) to ensure the process is meeting specified standards. If not, then management intervenes and corrective action is taken to bring the process back within standard.
- **Quality assurance (QA)**  
The minimum level of acceptable quality at all stages of the process is continually monitored by actual measurement and comparison against pre-determined standards, i.e. international quality standards (ISO).
- **Quality improvement (QI)**  
Maintaining competitive advantage by making continuous improvements – improve quality over time by reducing error, and finding better ways of performing the tasks leading to lower cost or higher quality at the same cost. More of a holistic approach, responsibility of everyone and involves all aspects of this business. Is also known as TQM (total quality management).

## h) Overcoming Resistance to Change

There is a range of external factors which encourage, precipitate or even force necessary changes in a business operation. That is to improve operations there is often a need to implement big changes. This can be difficult because there are significant restraints and restrictions to implementing change. There are two categories:

### ■ *Financial Restrictions*

Resistance to change because of the direct and immediate cost of those changes.

- (a) Cost of New Equipment. i.e. Machinery/technology can be very expensive
- (b) Redundancy Costs. To implement staff reductions incurs mandatory redundancy payments to the workers retrenched. Can be very high, depends on length of service, level of pay, and outstanding entitlements.
- (c) Retraining Costs. Significant change incurs retraining expenditure.
- (d) Plant Layout Costs. Reorganisation of the layout within the factory.

### ■ *Human Restrictions*

Resistance to change because of the impact, real or imaginary, on the individual and on the established working groups.

- (a) Inertia. The unenthusiastic response of some managers, some staff and even some of the owners.
- (b) Change in skillset. Staff will be apprehensive about what the changes mean. Their current skills may no longer be required. They will be required to learn new skills. This gives rise to feelings of personal insecurity and inadequacy, particularly in older staff.

## i) Global Factors

Business operations cannot avoid the influence of globalisation. This presents opportunities to improve operations but it also creates new risks (volatile markets, different laws etc.).

### 1) *Global Sourcing*

This is the strategy of acquiring production inputs from overseas in order to lower costs and or improve quality. The most obvious example is having labour-intensive tasks performed in countries with lower wage rates such as China. There are other benefits such as access to new technology or special resources or special labour skills not yet in the home country.

Global sourcing decisions bring their own challenges:

- Greater management complexity;
- Different legislative and regulatory frameworks, especially in contract and proprietary protection law;
- Different cultural behaviour and different languages;
- Some increased costs such as relocation and logistics;
- Exchange rate variations

## 2) *Economies of Scale*

By expanding overseas businesses can produce more and achieve economies of scale. This is the opportunity for lower production costs derived from larger production runs. High volume production runs yield lower unit cost of product. NB. By global standards, Australia is quite a small market and small local production runs can have a high per unit capital cost.

## 3) *Scanning and Learning*

Increased globalisation brings increased competition, more new technology and hence continuing change in the business environment. Scanning and learning means finding out and implementing ideas about operations overseas.

## 4) *Research and Development (R & D)*

This is the systematic process to come up with new methods of conducting operations – creating new products and production processes. This is vital for business innovations.

### Exercise 1.3

Indicate whether each of the following statements is true or false

True / False Questions	True / False
1. Many businesses have rationalised their number of suppliers.	
2. High levels of inventory will decrease storage costs.	
3. Technology has made inventory management more efficient.	
4. Reduced costs are the main reason outsourcing is popular.	
5. The shorter the lead time the less flexible purchasing inputs becomes.	

## 5. Effectiveness of Operations Management

Operations management can be evaluated through 6 performance objectives.

As with all strategies or tactics, the starting point is a set of goals or performance objectives. Performance objectives are goals that relate to particular aspects of the transformation processes.

**Quality** is often determined by consumer expectations, which inform production standards. Consistently producing goods and services to customer expectations. Good quality prevents costs caused by product recalls and repairs made under warranty.

**Speed** refers to the time it takes for the production and the operations processes to respond to changes in market demand. Goals for speed include:

- reduced wait times
- shorter lead times
- faster processing times.

### Case Study Dominos

The Dominos pizza chain keeps coming up with new ways to make ordering and delivering pizza's quicker. New fast bake convention ovens speed up cooking times. Their new mobile app includes several digital products which speed up ordering.

- Pizza builder allows customers to customise their orders online
- Pizza profiles allow returning users to have their details, preferences and payment information pre-entered
- Pizza tracker allows customers to have immediate updates on the progress of their order

**Dependability** (reliability) refers to how consistent and reliable a business's products are. For goods, this is how long they last (durability) and can be measured by warranty claims. For services, this is how consistent standards of service are and can be measured by number of complaints received.

**Flexibility** (adaptability) refers to how quickly operations processes can adjust to changes in the market, either by increasing volume, adding variety or changing products offered. Changes in market demand cause a pressure on capacity. Utilising new technology, adopting more efficient process layout or changing product design can help achieve flexibility.

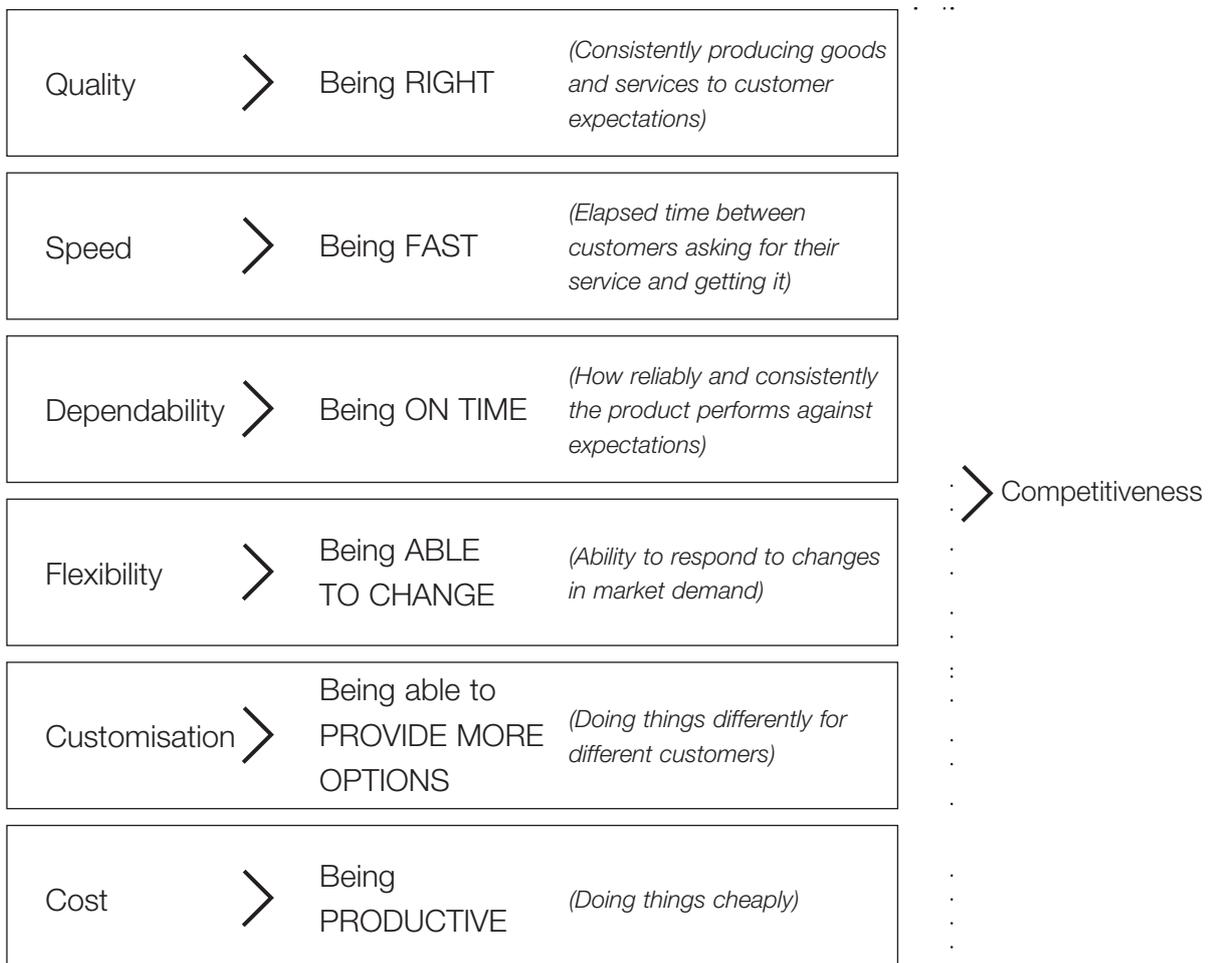
**Customisation** refers to creation of individualised products, i.e. doing different things for different customers. Remember, goods tend to be standardised and services tend to be customised.

For goods, variations in features such as colour, size and functionality offer some level of differentiation between products but are still done on a mass scale, known as mass customisation. The cost of customisation is higher than the cost of mass producing standardised products. For this reason, only businesses with a product that can be easily adapted tend to customise unless the actual business model is one of a customised approach to all products.

**Cost** as a performance objective refers to the minimisation of expenses i.e. doing things as cheaply as possible. Often the costs of operations will determine the price so improving efficiencies in processes and obtaining cheaper inputs can lower price. Costs in operations may be reduced by:

- Utilising new/leading-edge technologies
- Minimise waste in production
- Use inputs more effectively
- Reduce supplier costs
- Manage inventory effectively
- Maximise flexibility

**Figure 5 Effectiveness of Operations Management**



**Exercise 1.4 Multiple Choice**

Select the alternative A, B, C or D which best answers the question.

**1. *What is the role of operations?***

- a) Source finance for the business
- b) Develop newly hired staff
- c) Determine promotion strategies
- d) Transform inputs into outputs

**2. *Which is the most likely result of a business achieving economies of scale?***

- a) Higher average cost of production
- b) Greater efficiencies in production
- c) Greater flexibility
- d) Higher sales price per unit

**3. *A manager consults a manufacturing team to assist in creating a new staff training program***

This demonstrates the interdependence of which two business functions?

- a) Finance and Marketing
- b) Marketing and Operations
- c) Operations and Human Resources
- d) Human Resources and Finance

**4. *A shopping centre has decided to install 40 solar panels on its roof to reduce power consumption.***

Which of the following factors has been responsible for this decision?

- a) Globalisation
- b) Legal regulation
- c) Quality expectations

d) Environmental sustainability

5. *The recently elected Federal Government introduced new laws that increase restrictions on carbon pollution. 'Perfect Power' has also received numerous letters and emails from stakeholders protesting the level of pollution they generate from the burning of coal.*

Which two factors are influencing the business's operations?

- a) Globalisation and quality expectations
- b) Quality expectations and legal regulations
- c) Legal regulations and environmental sustainability
- d) Environmental sustainability and globalisation

6. *How should an Australian firm operating a clothing factory in Bangladesh ensure they act in an ethically responsible manner?*

- a) The business should comply with foreign environmental laws
- b) The business should ensure that copyright and patents are not broken
- c) The business should provide work health and safety conditions that go beyond the scope of the foreign laws.
- d) The business should provide wages and working conditions in accordance with the foreign laws.

7. *Which of the following operations influences would increase short-term costs but should lower long-term costs?*

- a) Increased quality expectations
- b) Increased technology
- c) Government policies which increase legal regulations
- d) Increased environmental sustainability

8. *What term describes the process where a manufacturer promises to fix a defect that occurred in the making of product?*

- a) Customer service
- b) Quality control
- c) Guarantee
- d) Warranty



12. Which of the following combinations would result in the highest production cost per unit?

- a) Extensive customer contact, extensive product variety and low volume
- b) Extensive customer contact, extensive product variety and high volume
- c) Limited customer contact, limited product variety and low volume
- d) Limited customer contact, limited product variety and high volume

13. A Gantt chart for Waz's Coffee Shop is shown.

	Jan	Feb	Mar	Apr	May	Jun
Obtain lease and refit shop	■					
Purchase stock		■				
Select and train staff			■			
Advertising campaign				■		
Commence trading						■

What does this Gantt chart show?

- a) Selection and training of staff will begin in February
- b) All stock will be purchased before the advertising campaign begins
- c) Trading will commence only once the advertising campaign has concluded
- d) Select and train staff and the purchase of stock will be done simultaneously

14. The management of Springbok Ltd is looking to implement an operational strategy which will improve transportation, warehousing and packaging of its products.

Which of the following concepts is management concerned with?

- a) Distribution strategies
- a) Logistics
- a) Global sourcing
- a) Performance objectives

15. A manufacturing company is replacing a range of manual tasks with automated machinery. They have offered the affected staff attractive voluntary redundancy or retraining.

What operations strategy is this?

- a) FIFO
- b) Global factors
- c) Quality management
- d) Overcoming resistance to change

### Exercise 1.5

ABC Underwear is a well-known underwear brand that is currently manufactured in North Sydney. The high quality brand is becoming more recognised and demand for their products has increased. Recently, they have been contacted by stores and consumers overseas who are interested in buying their underwear.

- a) Outline ONE aspect of the 'strategic role' of operations at ABC Underwear. (2)

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- b) With reference to ABC Underwear, explain the interdependence between operations and finance if the business expands globally. (4)

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**Exercise 1.7**

Skinstad's café operates in Western Sydney. Unfortunately their operational process is ineffective and as a result some of its costs are rising. Consequently there has been a decrease in the company's profit.

a) Identify TWO operational performance objectives. (2)

OBJECTIVE 1: \_\_\_\_\_

OBJECTIVE 2: \_\_\_\_\_

(b) Explain how Skinstad's cafe could use technology to improve the efficiency of its operational process. (4)

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(c) Using examples, explain how Skinstad's café could achieve corporate social responsibility. (4)

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## Answers to Exercises

### Exercise 1.1

1. True, 2. False, 3. False, 4. True, 5. False

### Exercise 1.2

1. Global Web, 2. Compliance cost, 3. Corporate social responsibility, 4. Technology, 5. Globalisation

### Exercise 1.3

1. True, 2. False, 3. True, 4. True, 5. True

### Exercise 1.4

1. D, 2. B, 3. C, 4. D, 5. C, 6. C, 7. B, 8. D, 9. A, 10. B, 11. B, 12. A, 13. B, 14. B, 15. D

### Exercise 1.5

- a) Answers could include: Good/service differentiation, cost leadership  
Sample Answer: As ABC Underwear is a 'high quality underwear brand' the main role of operations management at ABC Underwear is to focus on goods/service differentiation. This is where a business aims to achieve a competitive advantage through product differentiation, in this case, excellent quality.
- b) Sample Answer: Interdependence is the mutual dependence that finance and operations have with each other as they both work towards common goals. Operations refers to the business processes that involve transforming inputs into outputs (production). At ABC Underwear, operations depend on finance (the planning and monitoring of a business's financial resources) to allocate budgets/finance and manage the payments for the purchase of inputs such as raw materials (cotton), machinery and staff (machine operators). The budgets allocated will determine the quality of inputs acquired (a high quality level to maintain premium underwear). Finance relies on operations to produce underwear that meets consumer needs (high quality) which will generate sales revenue income for the business. Finance also expects operations to be managed efficiently and effectively to minimise costs to maximise profitability (eg Checking raw material deliveries in and out of the stock receiving areas to ensure the correct amount is received and paid for).
- c) Sample Answer: Globalisation refers to the removal of barriers of trade between nations. It allows consumers the opportunity to purchase products from businesses that provide the most value for money, which could dramatically impact on ABC

Underwear's operations, particularly in the need to be price and quality competitive. Globalisation will enable ABC Underwear to source raw materials using global supply chains ("global web"); these inputs may be of better quality or lower cost. Global outsourcing of production is another opportunity which could be explored, to take advantages of lower wage costs overseas. Globalisation will also allow ABC Underwear to sell its outputs to global consumers who desire global brands, as well as expanding the overall market for a business' output, possibly resulting in the achievement of economies of scale for the operations of the business.

### Exercise 1.6

- a) Answer could include: Quality, Speed, Dependability, Flexibility, Customisation, Cost  
Sample answer: Performance objectives are goals that relate to particular aspects of the production process. Two Performance objectives are Quality and Cost. Quality is how well designed, made and functional goods are and the degree of competence with which services are delivered. Quality can be achieved through operations management by the quality of design that determines the inputs that go into the product. By sourcing the best quality inputs the performance objective of quality can be achieved. Cost as a performance objective refers to the business making efficiency savings and eliminating waste to ensure that products are produced as cheaply as possible. This can be achieved using technology in production that ensures accuracy to minimise waste and can substitute for labour to minimise wages expenses.
- b) Sample Answer: Technology refers to the design, construction and/or application of innovative devices, methods and machinery upon the production process. Technology could be office technology to improve planning and administration of business activities or manufacturing technology that increases speed efficiency and accuracy in producing goods and services. Technology involves an investment by business and therefore an upfront cost or expense; it also may involve staff retraining or redundancies. This can be costly in the short run but technology can increase efficiency (it can be run 24 hours a day) and quality (it makes fewer errors) so in the long run it improves quality and reduces costs. Qantas have introduced new Dreamliner aircraft (leading edge technology) to their fleet. This improves the quality of the service for Qantas as the planes are quieter and more comfortable for passengers and lower pressurisation in the cabins leads to less jet lag giving Qantas an edge over other airlines. Furthermore, the new technology planes are more fuel efficient reducing Qantas costs and giving them a financial advantage over competitors. This allows Qantas to be price competitive allowing them to achieve a long term competitive advantage over other airlines that do not have new airplanes.

**Exercise 1.7**

a) Answers could include: Quality; Flexibility; Speed; Customisation; Dependability; Cost

b) Answers could include: Leading Edge Technology, Established Technology

Sample Answer: Technology refers to the design, construction and/or application of innovative devices, methods and machinery upon operations. Improving efficiency will enable the business to cut costs and increase profits. Leading Edge Technology is the technology that is the most innovative at any point in time. Skinstad's cafe may implement use of the mobile phone APP "Beat the Queue" which allows the customer to order & pay for their food and drink online/on their phone and then collect. Skinstad's cafe may use established technology such as computerised stock management systems (with barcoding) to track stock for more efficient ordering and reduced waste/stock loss. Established technology is technology which is already being tested and found to be successful in increasing a business's efficiency.

In these examples, technology will allow the business to achieve improved efficiency by cutting costs, improving the speed of production, improving quality and dependability of the output and reducing waste in the production process. Technology can also enable the business to cut back on its staffing requirements and labour costs.

c) Answers could include:

Sample Answer: Corporate Social Responsibility (CSR) is an important influence on business and it integrates financial, social and environmental goals. It involves Skinstad's cafe going above the basic legal requirements and addressing broader social, community and environmental goals.

E.G. Skinstad's cafe can achieve better CSR by not only complying with Labour Laws for workers in the Café but allow some flexibility in terms of special sick leave etc. Environmental sustainability and social responsibility are features of an ethical approach to operations management.

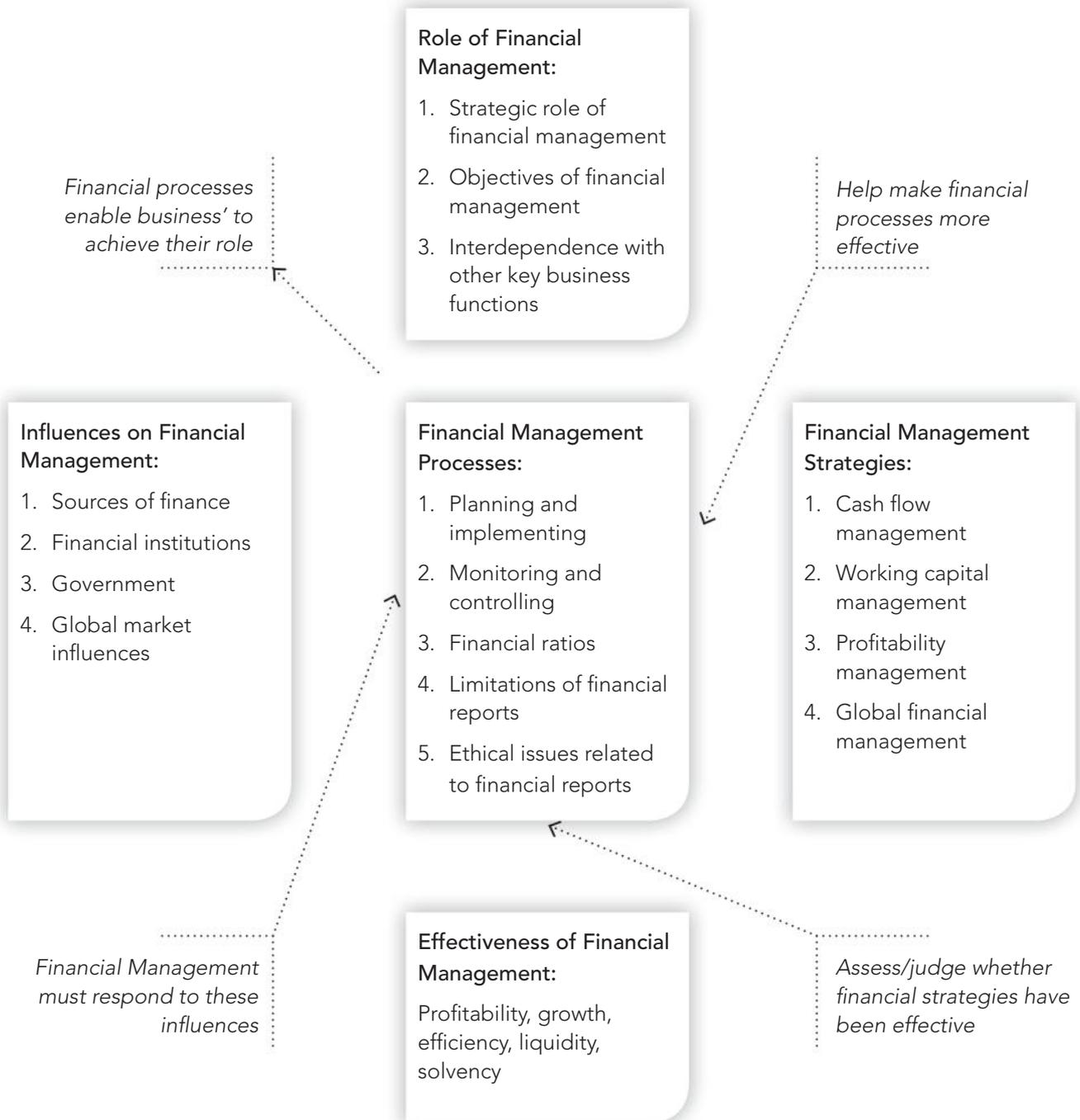
Skinstad's cafe can address the issue of waste management by becoming a café that only serves coffee and tea to customers with their own plastic recycle "Keep Cup". All food that is served in the café is not placed in Styrofoam containers.

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# Chapter 2

## FINANCE

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## 1. The Role of Financial Management

### a) The strategic role of Financial Management

The strategic role of financial management is the long-term planning and monitoring of a business's financial resources to enable the business to achieve its financial objective of profit maximisation.

Financial management is managing the financial resources of the business. It plays a crucial and long-term role because:

- finance plays a key role in every aspect of the business
- it is usually done by senior management (big boys)
- enables the business to achieve its goals
- it is essential for business growth
- it is often one of the biggest causes of business failure, it is essential for survival

For an organisation to achieve its long-term goals it must have a number of specific short-term objectives.

They are:

- Liquidity
- Profitability
- Efficiency
- Growth
- Solvency

These objectives will be covered at the end of this topic as a means of measuring the effectiveness of a business' financial management.

### b) Interdependence with other key business functions

Each function must interact with all of the other functions in order to achieve the goals of a business.

Because of its central role, financial management must be performed in coordination with other business activities.

**Finance** depends on marketing to generate funds. Also marketing strategies are expensive and needs to be funded. A marketing plan includes a major financial dimension. Budgets for each of business segment etc. and its related marketing strategies are key components of its marketing plan. Also marketing strategies are judged using financial criteria like sales, market share and profitability analysis.

**Human resources** require funds to remunerate staff as well as funding effective human resource strategies like training and development. Staffing is usually one of the biggest expense and effective management of staff is essential to maintain profitability and productivity. The financial function depends of the HR function to provide it with the appropriate staff needed to operate the financial function.

The **operations** function also requires funds. Budgets and cost controls are also required by each operational department. The financial function relies on operations to produce a good or service which can be sold to customers to generate future funds.

### Exercise 2.1

Indicate whether the following statements is true or false.

True / False Questions	True / False
1. The strategic role of financial management is to meet the needs and wants of consumers.	
2. Liquidity is defined as: The ability to convert assets into cash to meet current liabilities	
3. There are only three functions of a business.	
4. Outsourcing is a financial objective of a business.	
5. The operations function is dependent on the financial function to provide it with the funds it requires to purchase the inputs it needs for the production process.	

## 2. Influences on Financial Management

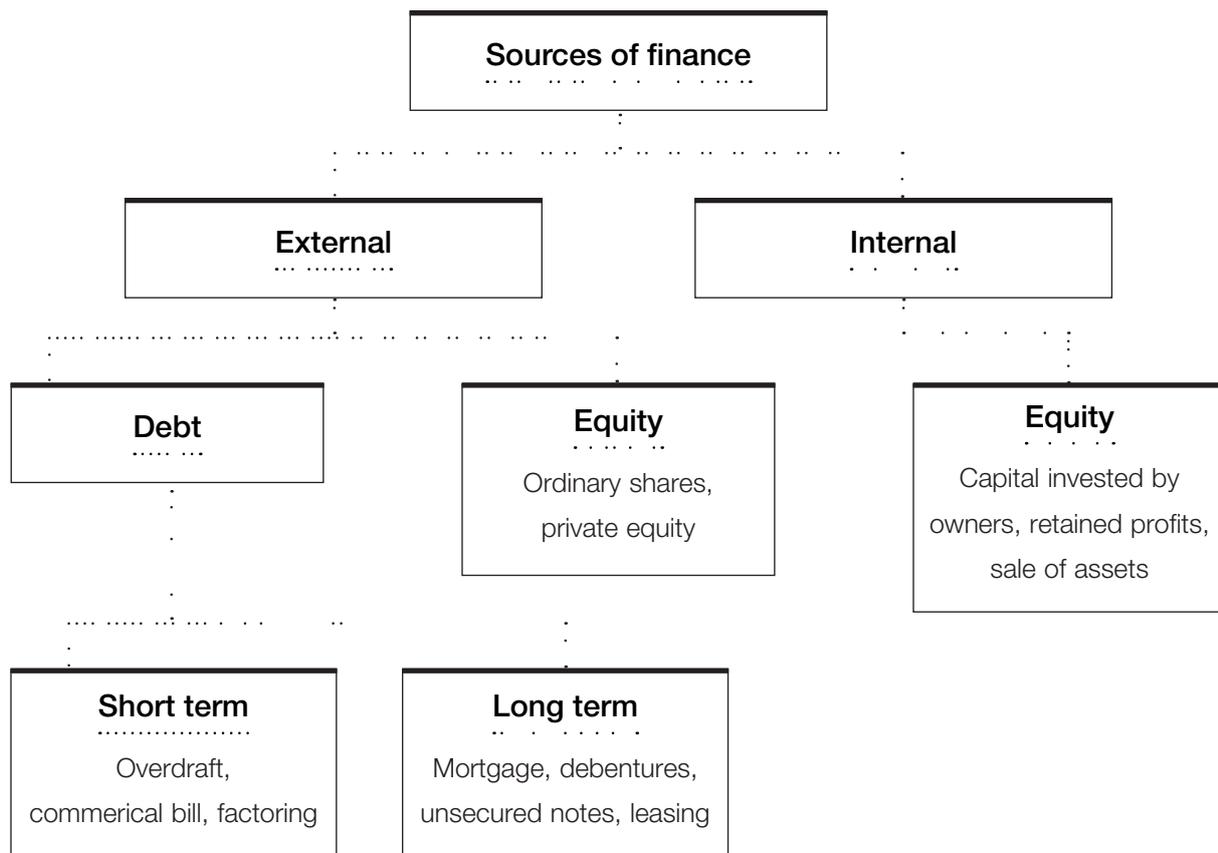
A business cannot establish itself and thrive without funds to enable it to pursue its activities.

Finding the appropriate sources of funds for the business's needs involves financial decision making.

### a) Sources of finance

Businesses need funds to establish, operate and grow. There are a couple of options:

**Figure 6 Sources of Finance**



**Internal Sources** – these are funds that come from within the business. Can only be equity finance (funds provided by the owners). You can't borrow from yourself so, no debt finance here. The main types of internal sources are:

- Retained profits – profits that are kept, not distributed to owners - It is the profit from business activities that is left after taxes, interest and dividend payments. These profits are reinvested into the business.
- Sale of assets

**External Sources** – these are funds that come from outside the business. This can be either equity or debt finance.

1) Debt Finance – relates to the short-term and long-term borrowing from external sources by a business, i.e. when a business borrows funds.

- Involves a contractual relationship (loan contract i.e. length of time, interest rates, fees, default penalties).
- Failure to pay debt back will probably result in legal proceedings (liquidation).
- Provided by non-government and government sources (usually non-government).
- Can be secured or unsecured.
- Classified as either short term or long term.

a) **Short term** – repaid within one year, used for temporary cash shortages and for funding working capital like inventory. It Includes:

- Bank Overdraft where the bank allows a business to overdraw its cheque account to a prescribed limit. These are often used to overcome a temporary cash shortfall. The interest rate is VERY HIGH but interest on the loan is only charged daily when the overdraft is used/on amount of money drawn out. Advantage: This type of finance is very flexible as the business accounts can go into positive and negative figures at any time, allowing the business to pay off short term [often seasonal] debts whenever they want.
- Commercial Bills (or Bank Bill) where the borrower receives the sum immediately and promises to pay the money in full with interest at the end of the term. Usually for big amounts \$100 000 or more and run for 30 to 180 days. Typically for funding of accounts receivable, inventory and meeting short term liabilities.
- Factoring enables the business to raise funds immediately by selling its accounts receivable to a factor company at a discount. The factoring company pays a lower price than the value of the invoices (usually between 80-90%). WHY factor? To realise/release cash to finance operations, minimise credit control, pay off urgent expenses and recoup some of the bad-debt losses.

**Figure 7 Advantages and Disadvantages of Factoring**

Advantages of factoring	Disadvantages of factoring
<ul style="list-style-type: none"> <li>■ Immediate access to funds</li> <li>■ Don't have to chase up accounts receivables</li> </ul>	<ul style="list-style-type: none"> <li>■ Don't get the full amount</li> <li>■ May be perceived to your customers that you are in financial trouble</li> <li>■ You don't control the methods used to collect the debt</li> </ul>

**b) Long term** – i.e. repaid over a long period, greater than 1 year. In the case of a mortgage this can be over 20 years. It is used for big purchases like property and equipment etc. It includes:

- Mortgage is a loan to fund purchase of property and that asset becomes security. The interest rate can be variable or fixed.
- Debenture is like a term deposit but with a company and not a bank. They are secured over the assets of the business. This is a long-term loan from investors. These are issued by a company for a fixed rate of interest and a fixed period of time. Investors receive regular, fixed interest payments.
- Unsecured note is usually issued by finance companies. They are not secured against the business's assets; therefore, the interest rate is higher. They are also known as bonds. Borrower must pay a specified amount of interest and pay the entire amount borrowed on maturity. These are a form of long-term loans from individuals or institutions for a set period of time. This means that there is a greater risk for the lender, and therefore the business pays a higher interest rate. Companies sell unsecured notes to generate money for their initiatives, such as share repurchases and acquisitions.
- Leasing is a contract between an owner of an asset (lessor) and a business which wants to use the asset (lessee). It enables the business to use the asset straight away, without a large capital outlay, in return for a monthly lease payment which is tax deductible. Businesses commonly lease premises, equipment, technology etc.

**Figure 8 Advantages and Disadvantages of Leasing**

Advantages of leasing	Disadvantages of leasing
<ul style="list-style-type: none"> <li>■ No large capital outlay (small monthly fee)</li> <li>■ Much easier to update</li> <li>■ Lease payments are tax deductible (expense for the business)</li> </ul>	<ul style="list-style-type: none"> <li>■ Can't take advantage of capital appreciation</li> <li>■ Do not own the asset once the lease contract is up</li> </ul>

## 2) Equity

Remember equity finance comes from the owners and it can be internal or external. External equity finance includes ordinary shares and private equity. This involves giving individuals or institutions a share of the ownership of the business in return for funds.

Ordinary Shares: These are issued by public companies through ASX to the public through a prospectus. Shareholders become owners and score a dividend (and hopefully capital gain when they sell). Variations include:

- New issue – first timer, also called a float (primary market). This is done through an ‘Initial Public Offering’ (IPO).
- Rights issue – existing shareholders are offered extra shares in proportion to their current holdings to enable them to maintain their percentage shareholding in the company.
- Placements – offer additional shares to specific investors and institutions. This is not done via a prospectus.
- Share Purchase Plans – offer existing shareholders the opportunity to purchase more shares at a discount (no brokerage).

Private Equity: This is a form of equity finance that involves giving large financiers external to the company a proportion of ownership in return for an injection of funds. This is an issue of shares by private companies (not listed on ASX, you have to be invited). E.g. Owners of private companies selling equity in the business to the sharks on the “Shark Tank”.

### Exercise 2.2

Indicate whether the following statements are true or false.

True / False Questions	True / False
1. Debt funds are provided by the owners.	
2. Retained profit is a type of debt finance.	
3. Debentures are issued by a company for a fixed rate of interest.	
4. Debt finance can be classified as either short term or long term.	
5. Debt finance is external finance.	

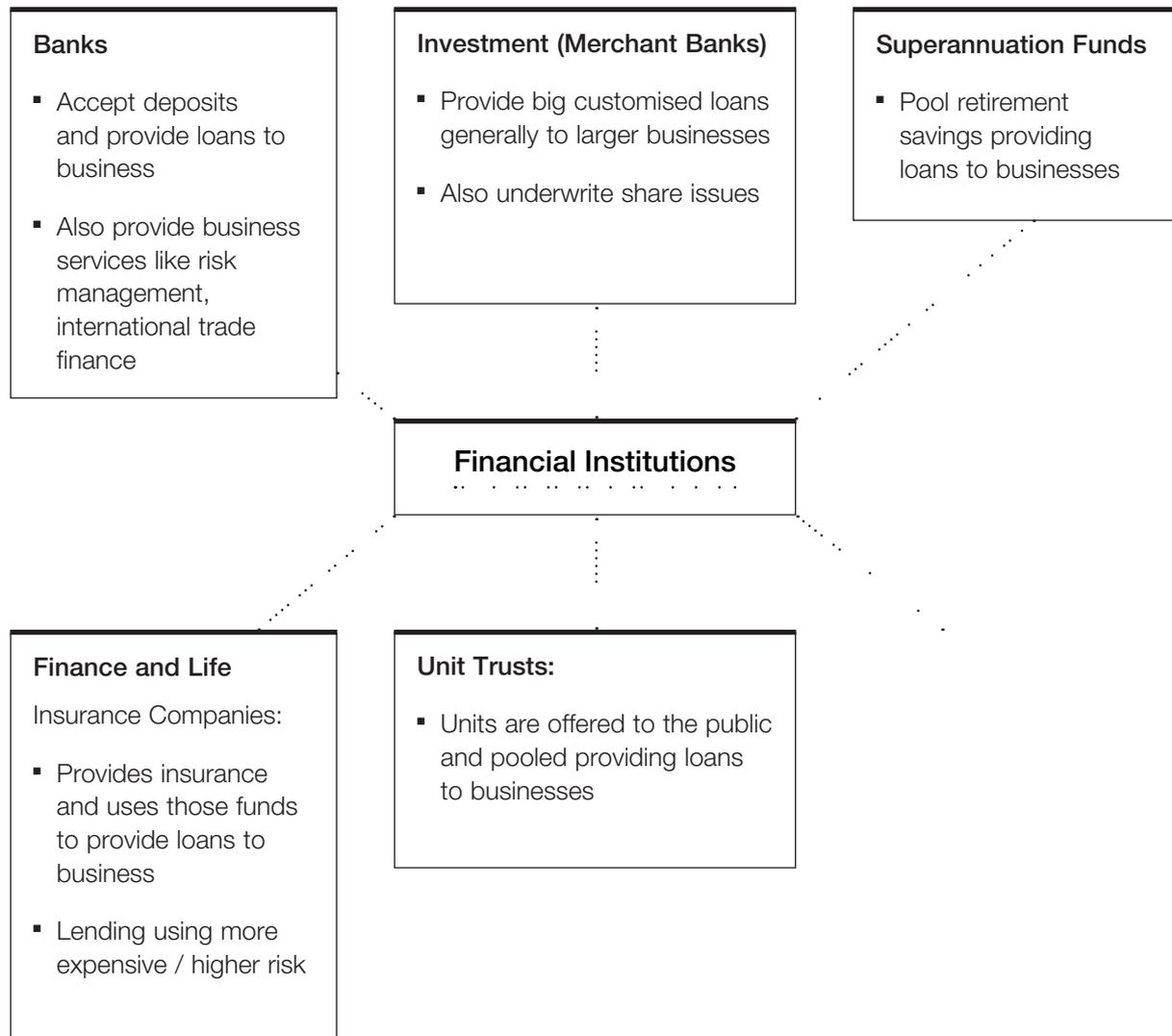
### b) Financial Institutions

Financial Institutions in financial markets are very important to a business because they are the organisations, which provide funds for:

- Business to start up,
- Invest in new plant and equipment
- To grow

They provide finance services (investments, loans) to business.

Figure 9 Financial Institutions



**Banks:** Banks are one of the main types of financial institutions and one of the main sources of finance for individuals and small businesses. They provide businesses and individuals with both short-term finance such as overdrafts and long-term finance such as mortgages. Banks receive savings as deposits from individuals, businesses and government, and, in turn, make investments and loans to borrowers. E.g. CBA or Westpac

**Investment Banks:** Investment banks are financial institutions that offer funding primarily to businesses (tend to not focus on individuals). They offer short and long-term loans, and often offer greater variety of loan types than the major banks. They also offer advice to businesses and can help arrange any type of finance required by the business. E.g. Macquarie Bank

## Case Study



Headquartered in Sydney, Macquarie is the largest Australian investment (merchant) bank. The bank employs over 130000 staff in over 27 countries.

Macquarie deals mostly in international finance, business loans for companies and share underwriting. Macquarie are experts in international trade, which makes them specialists in dealing with multinational corporations. They also provide advice to companies regarding potential mergers and acquisitions, and provide investment research to clients.

The bank's high profits and lucrative rewards for its executive team saw it labelled by the media as the "millionaires family".

**Finance Companies:** Finance companies are non-bank financial institutions that specialise in smaller commercial finance. They provide short and long-term loans mostly to medium and small businesses. Finance companies tend to take on risky loans which means the businesses must pay a higher interest rate to compensate the finance company for the additional risk. E.g. Pepper Financial Services Group.

**Life Insurance Companies:** Life insurance companies provide insurance for people in the event of death. These companies use money that customers pay for purposes such as: equity and loans to the corporate sector. These companies therefore pool together large sums of money, making funds available for business financing – either by directly buying shares or depositing money in banks which is lent to businesses. E.g. Suncorp

**Superannuation Funds:** After banks, these are the next largest group of financial institutions in terms of their financial assets. These businesses provide funds to the corporate sector through investment of funds received from superannuation contributions. These institutions are major holders of shares and government securities and are also active in property financing. Due to Federal Government policy and law all employees must have at least 9.5% (rate until 2021) of their salary invested in superannuation. Superannuation funds therefore have very large amounts of money that need to be invested to make a return to pay for the retirement income of investors in the funds. E.g. NGS Super Fund

**Unit Trusts:** Unit trusts are funds that fund managers run on behalf of investors for a fee. These are also known as 'mutual funds. Fund managers invest money that investors contribute in various ways in an effort to grow the size of the fund, such as buying shares. This pools together large amounts of money which makes funds available for business financing, such as share issues. Unit trusts are usually connected to a management firm that manages a diversified investment portfolio for its investors. E.g. Macquarie Master Small Companies Fund

**ASX:** It allows companies to issue their first issue of shares on the ASX i.e. it operates as both a primary and secondary market. Primary market: deal with the new issue of shares or debt instruments by the borrower of funds. Secondary market: deal with the purchase and sale of existing securities between shareholders. ASX has supervisory responsibilities over companies listed on it. It can suspend the trading of a company's shares if it does not abide by its rules of behaviour and disclosure. It provides listing and trading facilities for public companies and thus allows companies to raise funds from the public.

### c) Influence of Government

As an economic manager the federal government influences a business's financial management decision making by:

- Economic policies like Monetary Policies (interest rates)
- Economic policies like Fiscal Policy (tax and government spending)  
e.g. Company tax – flat rate on companies' profits, designed to help our competitiveness, create jobs etc.
- By setting up ASIC to enforce and administer the Corporations Act (reduce fraud and unfair practices, protect investors).

**Australian Securities and Investment Commission (ASIC):** ASIC regulates and monitors the activities of companies to ensure relevant corporate laws are followed. ASIC influences business decisions by regulating what companies may do. ASIC is an independent government body. It is set up under the Australian Securities and Investments Commission Act 2001 and carries out most of its work under the Corporations Act 2001. ASIC protects consumers in the areas of investments, life and general insurance, superannuation and banking. It aims to reduce fraud and unfair practices in financial markets.

**Company Tax:** Company taxation is the tax that companies must pay to the government on profits that they earn. At present the tax is levied at a flat rate of 30% and 25% for small businesses with an aggregate turnover of less than \$2 million.

### d) Global Market Influences

Global financial influences impact on Australian businesses. These are largely uncontrollable because they come from the external environment. Australian businesses need to put strategies in place to minimise their impacts.

Examples are:

- Global economic outlook – there is not only an Australian economic cycle but a Global economic cycle which varies among countries. This impacts on Australian business  
e.g. COVID-19 (depressed global economic outlook)

## Case Study COVID-19 Global Economic Recession

COVID-19 pandemic has triggered the most severe global economic recession since the Great Depression. Lockdown measures brought in by governments have slowed the spread of the virus and reduced the death toll, but they have frozen business activity throughout the world. The global economic outlook is highly uncertain. Estimates indicate COVID-19 will trim economies GDP by 5% and reduce global trade by 18%. The impact on Australian businesses is unprecedented with many businesses facing major hits to revenue and cash flow issues with the demand for goods and services considerably reduced. Many businesses have been forced to pause trading altogether. Businesses have been forced to renegotiate lease agreements, deferring loan repayments and investment plans.

- Availability of funds – means the ease with which businesses can borrow (get money). Depends on things like risk, demand and supply and economic conditions. E.g. the GFC caused a shrinkage of funds, higher interest rates associated with the increased risk of lending.
- Interest rates – cost of borrowing money. Not only does going global involve more risk it means there is a need for funds to pay for the expansion. Australian businesses have been tempted to borrow from overseas to take advantage of lower interest rates.

### Exercise 2.3

Indicate whether the following statements are true or false.

True / False Questions	True / False
1. The ASX is a government body.	
2. Investment banks traditionally focus on the consumer market.	
3. The rate of company tax for large companies is 30%.	
4. ASIC stands for: Australian Securities and Investment Club.	
5. Financial Institutions provide funds for businesses to start up.	

## 3. Processes of Financial Management

### a) Planning and Implementing

Planning enables the business to operate more efficiently. It also gives the business more direction and assists in coordinating activities to achieve stated objectives.

- Determine financial needs (funds required to start, operate and grow). The business must determine its current position so it can decide where the business is heading and how it will get there.

- Budgets (forecasts of future costs and revenues, used as a planning and control tool)
- Record systems (accounting system for collecting financial information, businesses need accurate, reliable, accessible financial information).
- Financial risks (aware of threats facing the business, insurance can reduce risk)
- Financial controls (policies and procedures of the business that ensure that the plans of a business will be achieved in the most efficient way).

### Debt and Equity Financing: Which is better? It depends.

Figure 10 Advantages and Disadvantages of Debt and Equity Financing

Advantages of debt	Disadvantages of debt
<ul style="list-style-type: none"> <li>■ Fast (simpler to arrange)</li> <li>■ Doesn't change the ownership structure of the business (debt holders have no voting rights) so owner maintains control</li> <li>■ Increased funds should mean higher profits</li> <li>■ Interest payments are tax deductible</li> </ul>	<ul style="list-style-type: none"> <li>■ Involves greater risk</li> <li>■ Lenders have first claim on business assets if business goes bust</li> <li>■ Have to pay interest (more expensive) and regular repayments</li> </ul>
Advantages of equity	Disadvantages of equity
<ul style="list-style-type: none"> <li>■ Involves less risk</li> <li>■ No interest (cheaper), no regular repayments</li> </ul>	<ul style="list-style-type: none"> <li>■ Slower to set up</li> <li>■ Changes the ownership structure (dilutes ownership) of the business (equity holders have voting rights)</li> <li>■ May mean lower profits</li> <li>■ Dividends are not tax deductible</li> </ul>

### Matching the terms and source of finance to business purpose

This means the finance choice (either short term or long term) depends on the finance use (current asset or non-current asset). Finance managers should match the length or term of the loan with the economic lifetime of the asset the finance is being used to purchase.

- Short term finance should fund (match) current assets
- Long term finance should fund (match) non-current assets.

Factors to consider in financing business activities:

- Set-up costs
- Interest costs
- Availability of funds
- Flexibility of funds
- Level of external control

### Exercise 2.4

Indicate whether the following statements is true or false.

True / False Questions	True / False
1. Inventory should be financed with a Bank Overdraft	
2. Global expansion should be financed by Commercial Bills	
3. Purchase of property should be financed by a Mortgage	
4. Purchase of technology should be financed by a Credit Card	

### b) Monitoring and Controlling

Financial statements are the main financial controls used for monitoring. They are financial reports which show how well the business is doing. They are used by management to help make decisions. They are required by law and have to be published for public companies. They include:

- Income Statement: A summary of the income earned and the expenses incurred over a period of trading
- Balance Sheet: Represents a business's assets and liabilities at a particular point in time and shows the net worth of the business.
- Cash Flow Statement: Indicates the movement of cash receipts (inflows) and cash payments (outflows) resulting from transactions over a period of time.

Figure 11 Income Statement for BRSS Pty Ltd

	For the period ending 30 June 2022 in 000's	For the period ending 30 June 2023 in 000's
Sales	2000	3200
Less COGS	800	1440
Gross Profit	1200	1760
Less Operating Expenses		
Selling Expenses	520	860
General Administration Expenses	80	130
Financial Expenses	400	320
Net Profit	200	450

*Points to note:*

- The Income Statement is a financial statement which shows whether the business has made a profit or a loss during a period of time.
- It's also known as a profit & loss statement or revenue statement.
- An income statement is completed before the balance sheet.
- Sales is revenue generated by the business.
- Cost of goods sold (COGS) is how much the goods or services have cost the business before sale. (COGS = Opening Stock + Purchases – Closing Stock)
- Gross profit = Sales – COGS
- Operating expenses are those expenses (costs) incurred in the normal operations of the business they are divided into 3;
  - a) Selling/distribution e.g. advertising
  - b) Administration/general e.g. insurance, utilities, office wages
  - c) Financial e.g. depreciation, interest
- Net Profit = GP – Expenses

Figure 12 Balance Sheet of BRSS Pty Ltd:

	\$ As at 30 June 2022 in 000's	\$ As at 30 June 2023 in 000's
<b>Current Assets</b>		
Cash at Bank	200	100
Accounts Receivable (debtors)	400	500
Inventory	900	1400
<b>Non-Current Assets</b>		
Property, equipment, motor vehicles	1500	1550
<b>Total Assets</b>	3000	3550
<b>Current Liabilities</b>		
Accounts Payable (creditors)	700	940
Accrued Expenses	50	60
Bank Overdraft	0	100
<b>Non-current Liabilities</b>		
Bank Loan	250	400
Shareholders Equity		
Share capital	1900	1900
Retained earnings	100	150
<b>Total Liabilities + Shareholders Equity</b>	3000	3550

*Points to note:*

- The Balance Sheet is a financial statement that shows businesses assets, liabilities and owners equity at a specific date.
- Also known as the Statement of Financial Position, i.e. how much the business is worth to the owners.
- It shows the accounting equation  $A=L+OE$
- There are 2 ways a balance sheet can be formatted: T-Account OR Statement form.

- Assets are items of value of the business owns. There are 3 types:
  - 1) Current assets – cash and other types of assets that are reasonable expected to be converted into cash, sold or consumed in the next 12 months. These include inventories, debtors and cash.
  - 2) Non-Current assets – (also known as fixed assets) are assets that are expected to be used for a number of years i.e. not held for resale, and except for land/buildings these assets have useful lives and are depreciated. They are not expected to be converted into cash within the next 12 months. This include property, fixtures and fittings, equipment and vehicles.
  - 3) Intangible assets- assets that usually do not have a physical substance but are expected to provide future benefits to the business e.g. goodwill, copyrights, patents and brand names.
- Liabilities show what a business owes. They can be classified into 2 categories:
  - 1) Current liabilities- amounts a business owes that is expected to repaid within 12 months.
  - 2) Non-current liabilities – (also known as long term liabilities) amounts a business owes that are not expected to be repaid within 12 months.
- Owners' equity – This shows the equity of the owner in the assets of the business.  
If the business is unincorporated (sole trader or partnership), owner's equity looks like:  
capital + net profit – drawings.  
If the business is incorporated (company) owners' equity looks like:  
shareholder's equity + retained earnings.

Analysis of the balance sheet can indicate whether:

- the business has enough current assets to cover current liabilities – liquidity
- the business has enough assets to cover its debts – gearing / solvency
- the interest and money borrowed can be paid
- the assets of the business are being used to maximise profits
- the owners of the business are making a good return on their investment.

Figures from previous years BS can be analysed to show changes and trends

Figure 13 Cash Flow Statement for BRSS Pty Ltd

	For the period ending 30 June 2022 in 000's	For the period ending 30 June 2023 in 000's
Total cash inflows	1800	2300
Total cash outflows	1700	2400
Net Cash Flow	100	-100
Cash at the beginning of the year	100	200
Cash at the end of the year	200	100

**Points to note:**

- The Cash Flow Statement shows the movement of cash inflows and cash outflows over a period of time.
- Only cash transactions are included in the Cash Flow Statement
- $NCF = TCI - TCO$  (Net cash flow = total cash inflows - total cash outflows)
- Cash at the end of the month or year =  $NCF + \text{Cash at the beginning of the month or year}$
- Cash Flows are usually divided into 3 categories: Operating activities, Investing activities and Financing activities.

**Operating activities:** these relate to the main activity of the business. Inflows = Sales, Outflows = Payments to suppliers, employees and other expenses

**Investing activities:** these relate to the cash inflows and outflows from the purchase and sale of NCA and investments.

**Financing activities:** these relate to the cash inflows and outflows from borrowing activities of the business. Inflows = equity such as issue of shares, Outflows = debt (payments for loans)

### c) Financial Ratios

Financial Ratios are mathematical tools which allow managers (& stakeholders) to analyse and interpret financial statements.

**1. Profitability ratios** – ratios which are used to evaluate a business' profit performance. They are expressed as a % and higher is always better.

**Figure 14 Profitability Ratios for BRSS Pty Ltd**

Profitability Ratios	Formulae	BRSS 2022		BRSS 2023	
a) Gross Profit Ratio	$\frac{GP}{Sales} \times 100$	$\frac{1200}{2000} \times 100$	60%	$\frac{1760}{3200} \times 100$	55%
b) Net Profit Ratio	$\frac{NP}{Sales} \times 100$	$\frac{200}{2000} \times 100$	10%	$\frac{450}{3200} \times 100$	14%
c) Rate of return on Owners Equity	$\frac{Net\ Profit}{Owners\ Equity} \times 100$	$\frac{200}{2000} \times 100$	10%	$\frac{450}{2050} \times 100$	22%

#### ANALYSIS

- a) The Gross Profit ratio has decreased from 60% (2022) to 55% (2023). This means that the proportion of GP that contributes to sales has decreased. BRSS is less profitable.
- b) The Net Profit ratio has increased from 10% (2022) to 14% (2023). This means that the proportion of NP that contributes to sales has increased. BRSS is more profitable.
- c) The Rate of Return on Owners Equity has increased from 10% (2022) to 22% (2023). This means that the return earned on owners funds by management has increased. BRSS is more profitable.

**2. Liquidity ratios** – ratios which are used to evaluate a business' ability to meet its short term obligations.

They are expressed as a ratio and higher is better (but too high may indicate that you are not using current assets effectively ie. idle cash). As a general rule:

Less than 1:1 – the business is NOT liquid

Between 2:1 and 1:1 – the business is liquid but NOT liquid ENOUGH

Over 2:1 – The business has excellent liquidity

Figure 15 Liquidity Ratios for BRSS Pty Ltd

Liquidity Ratios	Formula	BRSS 2022		BRSS 2023	
		a) Current Ratio (Working Capital Ratio)	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	$\frac{1500}{750}$	2:1

**ANALYSIS**

- a) The Current Ratio has decreased from 2:1 (2022) to 1.8:1 (2023). This means that BRSS is less able to meet its short-term obligations.

**3. Solvency / gearing ratios:** ratios which are used to evaluate a business' solvency (stability) and gearing (risk). It determines the business's ability to operate in the long term (measure of its financial stability). They are expressed as a % or a ratio and lower is always better.

A high gearing ratio means that a business is:

- Less solvent (stable)
- Exposed to greater gearing (risk)
- More vulnerable to an economic downturn
- More vulnerable to a rise in interest rates

There is no optimal level of gearing but a business should consider:

- Return on investment
- Cost of debt
- Size and stability of earning capacity
- Liquidity
- Purposes of short-term debt

Figure 16 Solvency Ratios for BRSS Pty Ltd

Solvency Ratios	Formula	BRSS 2022		BRSS 2023	
a) Debt to Equity Ratio	$\frac{\text{Total Liabilities}}{\text{Owners Equity}} \times 100$	$\frac{1000}{2000} \times 100$	50%	$\frac{1500}{2050} \times 100$	73%

**ANALYSIS**

- a) The Debt to Equity ratio has increased from 50% (2022) to 73% (2023). This means BRSS's gearing has increased (less solvent). BRSS is less financially stable.

#### 4. Efficiency ratios (ratios used to measure a business's ability to use its resources effectively)

Figure 17 Efficiency Ratios for BRSS Pty Ltd

Ratio	Formula	BRSS 2022		BRSS 2023	
a) Expense Ratio (The Lower the better)	$\frac{\text{Total Expenses}}{\text{Sales}} \times 100$	$\frac{1000}{2000} \times 100$	50%	$\frac{1310}{3200} \times 100$	41%
b) Accounts Receivable Turnover (The higher the ratio the better)	$\frac{\text{Credit Sales}}{\text{Accounts Receivables}}$	$\frac{2000}{400}$	5 times	$\frac{3200}{500}$	6.4 times
c) Average Collection period in days (The lower the number of days the better)	$\frac{365}{\text{Accounts receivable turnover}}$	$\frac{365}{5}$	73 days	$\frac{365}{6.4}$	57 days

NB Assume all sales are made on credit.

**ANALYSIS**

- a) The Total Expense ratio has decreased from 50% (2022) to 41% (2023). This means that the proportion of expenses that contributes to sales has decreased making BRSS more efficient.
- b) & c) The Accounts Receivable turnover has increased from 5 times (2022) to 6.4 times (2023). This means that BRSS is more efficient because they are collecting their accounts receivables faster. On average they used to collect every 73 days, now its down to 57 days.

The accounts receivable turnover ratio measures:

- the effectiveness of a firm's credit policy and how efficiently it collects its debts.
- It gives the number of times a year that the debtors are turned over or collected.
- A business would want the ART ratio to be as High as possible.

The accounts receivable turnover ratio in days:

- If the answer from the accounts receivable turnover ratio is divided into 365 days a business can determine the average length of time it takes to convert accounts receivable into cash.
- In this case, ideally the length of time is as few days as possible (lower is better).

#### **d) Comparative Ratio Analysis – over different time periods, against standards, with similar businesses**

For analysis to be meaningful, comparisons and benchmarks are needed.

Judgements are made by comparing a firm's analysis against other figures, percentages and ratios:

- Over different time periods
- Against standards
- With similar businesses

#### **e) Limitations of Financial Reports**

Financial reports are really useful, but they do have limitations (restrictions) and caution needs to be exercised with analysing these reports. Businesses want their reports to look good so often the financial reports can be inaccurate. Misleading information can lead to poor business decisions and therefore higher risk.

These limitations include:

- Normalised earnings: earnings that have been adjusted for changes in economic cycle and one off events. This is a limitation as business can decide if they would like to adjust earnings in a financial year and normalise them. Some financial managers may decide not to. Therefore it is subjective and stakeholders should note that earnings may or may not have been adjusted for one off events.
- Capitalising expenses: recording an expense as an asset on the Balance Sheet rather than an expense in the Income Statement (e.g. legal fees and stamp duty on the purchase of property). Therefore, it would be recorded on the balance sheet instead of the revenue statement and as such impact both financial statements. The expense is not included

in the calculation of profit therefore boosting profits and will inflate the asset base of the business and thus owners' equity (value) of the business on the balance sheet. Therefore, if businesses decide to "Capitalise Expenses" this may result in financial statements not truly reflecting the state of the business which is a limitation of financial reports.

- Valuing assets: Estimating the value of assets particularly non-current ones in the Balance Sheet can be difficult. Often these assets are recorded at historical cost (original price). This may distort the balance sheet because it may not accurately reflect their true worth (be much different from their market value). Land tends to increase in value and vehicles and machinery tends to depreciate. Accountants do depreciate some assets over time to present a more accurate picture. Intangible assets like goodwill are very difficult to value and caution need to be taken on their estimated value. Accountants are allowed to depreciate assets based on accounting standards due to wear and tear but the amount of depreciation is subjective. This creates 'grey areas' that businesses can exploit to create a misleading impression of their financial position, which limits the usefulness of financial reports. Hence this is a limitation of financial reports.
- Timing issues: Accountants may adjust timing of revenues and debt repayments to make the business look more profitable. Timing issues are a limitation of financial reporting as, for example, revenues should be matched on the income statement by the expenses used to generate them. If expenses for example, are held over to the next reporting period, a profit figure could be misleading. Businesses can exploit timing issues in financial statements to give a misleading impression of the financial position of the business, which limits the usefulness of financial reports. For example: Revenues could be delayed or accelerated to manipulate them into or out of the period covered by the report to give an inaccurate picture of the business's earnings.
- Debt repayments: Financial reports do not disclose specific information about debt repayments. The issue of debt repayments can limit the usefulness of financial reports as it may not be clear when the repayments have to be made, which can create a misleading impression about the financial position of the business. Businesses can renegotiate (re-finance) with suppliers and banks to delay debt repayments. The recording of debt repayments on financial reports can be used to distort the 'reality' of the business's status and this may be undertaken to provide a more favourable overview of the business at that point in time.
- Notes to financial statements. These are additional information that are included at the bottom of the reports. They include information that may be important to explain the financial statements such as accounting methods used to record transactions. Notes to financial statements are attached to primary statements to help readers better understand the financial reports. Information contained in these notes can be more subjective in nature and therefore have the potential to be misleading. These notes may add extra information not included in the main report, explain accounting methods used, or explain the reasons for certain financial outcomes. These notes are not regulated by law as strictly as the financial report itself, so the notes may in fact actually be used to mislead stakeholders.

## f) Ethical issues related to financial reports

Ethical behavior in financial management safeguarded by?

Laws regulate many aspects of financial reports, but there are several aspects in which businesses have scope to manipulate reports to make them unduly favourable, such as decisions about methods to value assets and whether to disclose extraordinary circumstances. Unscrupulous businesses can therefore manipulate financial reports to mislead stakeholders about the financial position of the business.

- Audits: independent examination of a business accounting system and financial reports. Audits provide an independent opinion as to whether the financial statements present fairly the financial position of the business. They allow users to place a greater reliance on that information.
- Professional accounting bodies: issue a code of professional conduct on ethical behavior including aspects such as compliance with the law and accounting standards, confidentiality of client information, competence etc. These rules are mandatory with severe penalties.
- Accounting Standards: establish the general principles to be followed in the preparation of financial statements.

### Exercise 2.5 Matching

Match the following statements with the correct terms below

1. Earnings adjusted to take into account cyclical changes in the economy	
2. Independent check on the accuracy of accounting	
3. Explains how a company finances its operations – either through debt or equity.	
4. A financial document used to project a business's future financial goals.	
5. When business owners take money out for their own use.	

**Word Bank:** audit, normalised earnings, budget, drawings, gearing

## 4. Financial Management Strategies

### a) Cash Flow Management

Cash flow is the money that is moving (flowing) in and out of your business in a month.

Cash flow management involves monitoring the business's cash flow and implementing strategies to result in a positive cash flow. One of the biggest problems for most businesses is maintaining positive cash flow or being liquid. A business must have enough cash available to pay expenses and current debts. Matching cash inflows with cash outflows is essential to avoid possible cash shortages in certain months.

#### **Potential issues:**

Temporary cash shortfalls – Many businesses use overdrafts to cover these shortages in cash. Banks allow the business to overdraw their account to a set limit with the payment of competitive interest rates.

Longer periods of cash shortfall are of greater concern for a business as this can lead to insolvency or bankruptcy.

It would be better to use long term debt finance to cover long periods of cash shortfall.

Why have strategies? To ensure that cash is available to make payments when they are due!

#### **Cash Flow statements**

A cash flow statement indicates the movement of cash receipts and cash payments resulting from transactions over a period of time. The Benefits: By keeping records of cash flow, you know how much cash you have in your bank account at a given time.

Businesses employ a number of other strategies to manage their cash flow:

- **Distribution of payments:** spreading expenses over the year (monthly) to ensure that not all large expenses occur at the same time. This can be done by delaying payments or paying in instalments. Paying in instalments is: a system for paying for an item in fixed amounts at specified intervals throughout the year.
- **Discounts for early payment:** encourages debtors to pay quickly which will immediately generate an inflow of cash for the business.
- **Factoring:** Selling accounts receivable to a factor company at a discount to generate an immediate inflow of cash. Even though the debtors are sold at less than their face value, the business gets access to cash quickly, thus helping their cash flow. They can use the cash to pay off expenses and creditors and avoid penalties

## b) Working Capital (liquidity) Management

WC management involves monitoring the business's WC and implementing strategies to result in a positive WC. Working capital is the amount of current assets required in the day-to-day running of the business. Current assets need to be well managed so that the business always has enough liquid assets to pay its immediate debts and bills as they fall due. Effective WC management will always mean the business's current assets are greater than its current liabilities.

### 1. Controls

#### *Controlling Current Assets*

##### ■ **Cash**

Cash has a critical role in determining liquidity. It ensures the business can pay debts, loans, can take advantage of investment opportunities, have sufficient funds to expand and pay drawings to owners or dividends to shareholders. Businesses should prepare a cash flow budget to manage cash flow. Management strategies to improve cash flow include, using overdrafts, encourage debtors to pay earlier, leasing, distributing payments for expenses evenly, using inventory management techniques to avoid a buildup of stock etc.

##### ■ **Receivables**

Collection of AR (Accounts Receivable) is important. The faster the business' debtors pay the better its liquidity position. A business should have an accounts receivable control system in place including:

- Terms for granting credit – length, credit limits, discounts given for prompt payment, interest charged on unpaid accounts
- Checking the credit ratings of prospective customers
- Following up on accounts not paid by the due date

NB The disadvantage of operating a tight credit control policy is that customers may go elsewhere.

##### ■ **Inventories**

Makes up a large chunk of current assets therefore their levels must be carefully monitored and managed. You don't want:

- a. Insufficient stock – it may lead to loss of customers as they may go to the competitor
- b. Excess stock – it may lead to cash shortages (also means increased costs e.g. Insurance, storage, stock take, security, wages etc.)

Business' need to have an inventory control system in place to:

- Estimate max and min levels of inventory to be used

- Control the size of orders
- Determine the reordering process
- The business may consider using a 'JIT' (Just In Time) stock system.

### *Controlling Current Liabilities*

#### ■ **Payables**

A business must monitor its accounts payable to ensure that their timing allows the business to maintain adequate cash reserves and a good supplier relationship.

Recommendations include:

- Holding back accounts payable to final due date of interest free trade credit to increase liquidity
- Look to take advantage of discounts
- Make sure you pay accounts by due dates to avoid extra interest charges or penalties if applicable and to maintain supplier relationships
- Review other suppliers and the credit facilities they provide
- The business may also be able to renegotiate later due dates for payments or refinance payables.

#### ■ **Loans**

Business' borrow funds in the short term and it is generally an expensive form of borrowing. Management of loans is important to minimise establishment costs, interest rates and ongoing charges. It also involves investigating alternative sources of funds to ensure the best short term loan is used.

#### ■ **Overdrafts**

Overdrafts allow the business to temporarily overdraw their cheque account. This needs to be managed by monitoring interest rates and bank charges. Most business' now use credit cards – very convenient but has high interest rates.

## **2. Working Capital Strategies**

The goal of working capital management is to conserve or preserve WC so there is enough cash to pay bills when they fall due, run the business on day-to-day level, but not conserve so much so that profitability is reduced.

Strategies for managing working capital (liquidity) include:

- Leasing is the hiring of an asset rather than buying it. The initial cash outlay for leasing is much lower than the cost of purchasing the asset upfront. This strategy frees up cash

(conserves or preserves WC) so it can be used elsewhere therefore improving the level of working capital. Regular lease payments can match the businesses cash flow.

- Sale and lease back is the selling of an owned asset like premises, equipment or motor vehicles to a lessor and leasing back that asset. That is making regular payments for a specified time period. This strategy would increase liquidity because the cash that is obtained from the sale is then used as working capital. This boosts (increases) the WC of the business because the payment they receive from the sale is much higher than the lease payments required.

### c) Profitability Management

Profit maximisation means maximising revenue and minimising costs.

#### 1. Revenue Controls

Revenues should be monitored and controlled to maximise profits. Marketing is the business function that generates revenues, and therefore controlling revenue is essentially refocusing on the marketing function.

Suggestions include:

- Setting up a sales reporting system that reports sales figures regularly and breaks them down into territory, person, product line etc.
- Setting clear marketing objectives / prepare a sales budget
- Examine ways to improve sales i.e. Improve marketing strategies through the 4 P's, target different markets etc.

#### 2. Cost Controls

Costs should be monitored and controlled with the aim of reducing expenses and maximising profits.

- Monitoring the levels of fixed and variable costs. Fixed costs are costs not dependent on the level of business activity (output). Variable costs are costs that are directly related to the level of business activity. Managing these costs means comparing them to budgeted results and previous years to ensure costs are minimised. Once the FC and VC are identified the business can employ numerous strategies to control their costs and minimise their expenses:
  - Negotiating better deals from current suppliers or shopping around for cheaper suppliers
  - Using contract or casual staff to reduce the 'on-costs'.
  - Finding cheaper suppliers of phone, internet and electrical services

- Training staff to become multi-skilled to enable the business to cut back on certain staff costs
- Outsourcing of certain business functions.
- Cost Centres are particular areas, departments, or sections of a business which costs can be directly attributed. This makes people more accountable for their costs. Firms split themselves into a number of cost centres to help them monitor and control the costs in different departments. This enables a business to pinpoint weaknesses in cash flow to each department and their overspending and losses.
- Expense minimisation are strategies to reduce costs and eliminate waste such as labour saving technology, downsizing staff (restructuring) and outsourcing.

#### d) Global Financial Management

There are a number of factors which make global business more complex. Businesses operating on a global scale face a range of financial risks in addition to the usual minefield of even domestic financial management. These 'extra' risks include:

- Exchange rates
- Interest rates
- Methods of international payment – payment in advance, letter of credit, clean payment, bill of exchange.
- Hedging
- Derivatives

##### 1. Exchange Rates and Currency Fluctuations

Global business requires trading with different currencies which are constantly changing. This impacts on a business' revenue, operating costs and profitability. The exchange rate is the price of one currency in terms of another (e.g. \$1 Aus equals \$0.71 US\$).

For an exporter the risk is that their currency appreciates

For an importer the risk is that their currency depreciates

##### 2. Interest Rates/Overseas Borrowing

Central banks adjust interest rates. A rise in the Australian interest rates relative to overseas rates may see investment funds flow to Australia and Australian business' borrowing overseas. In fact, traditionally interest rates tend to be higher in Australia because of our small capital market than those other countries. Borrowing overseas has become extremely popular with Australian business. The real risk is that the currency depreciates. This may erode any lower interest rate benefit.

The complexities of global business must be well managed. These issues include:

1. Methods of payment

Payment in global business is complicated by the fact that the business may be dealing with someone they have never seen, who speaks a different language, abides by a different legal system and uses a different currency. Selling goods overseas presents challenges and risks than selling domestically and therefore the business must select the appropriate method for payment. There is the risk that other party does not fulfil their side of the bargain. There are a number of methods of payment that can be used by global business. The method of payment chosen depends upon:

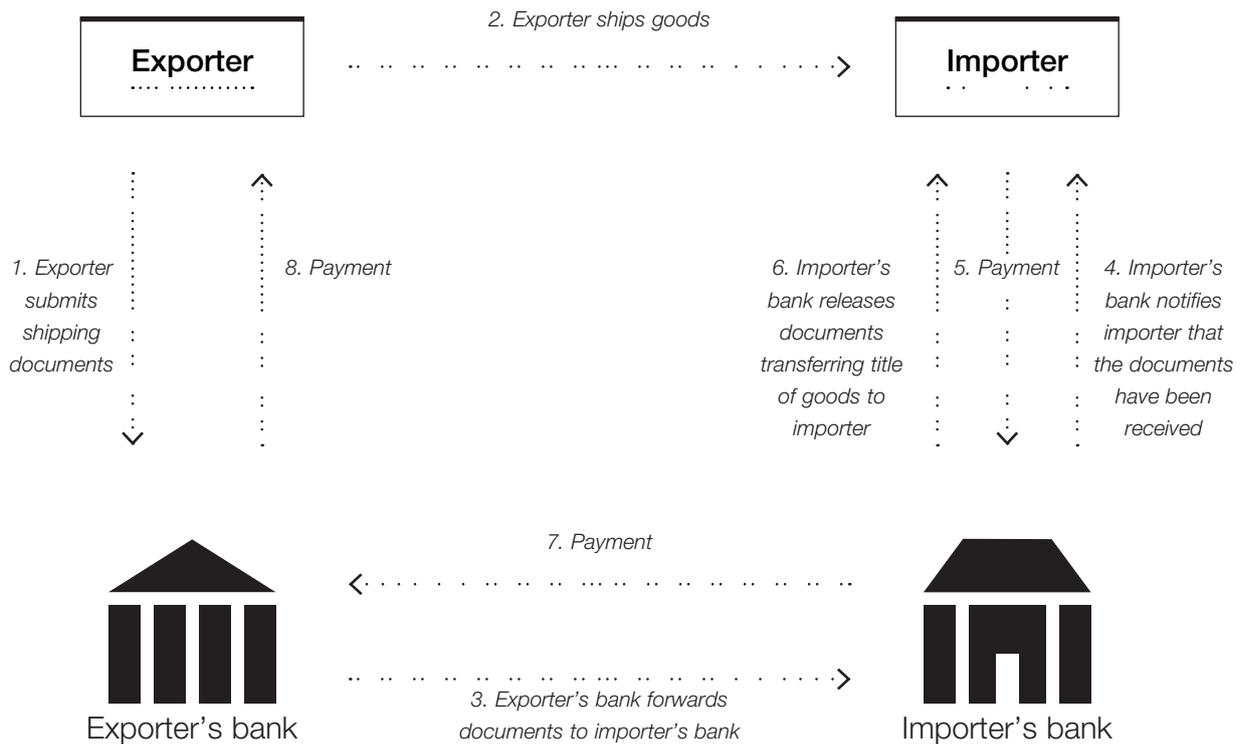
- Amount
- Perceived risk
- Relationship between buyer and seller
- Industry practices
- Terms offered by competitors

- a) **Payment in Advance or Prepayment** – payment made in advance to exporter. It eliminates all risk for the exporter but is very risky for the importer.
- b) **Clean Payment** – payment for the goods are made by the importer after the goods have been received. This is also called open account and is essentially shipping in advance. Here the exporter ships the product before receiving payment from the importer. Here the importer is buying on credit and does not pay at least until the product has been received. This is very risky for the exporter and low risk for the importer.

With both these methods there is a clear winner and a clear loser. New methods were developed to even out the score (even out the risk). Both involve banks. Remember when banks are involved they charge fees. Both these methods are expensive therefore they are usually only used by bigger companies.

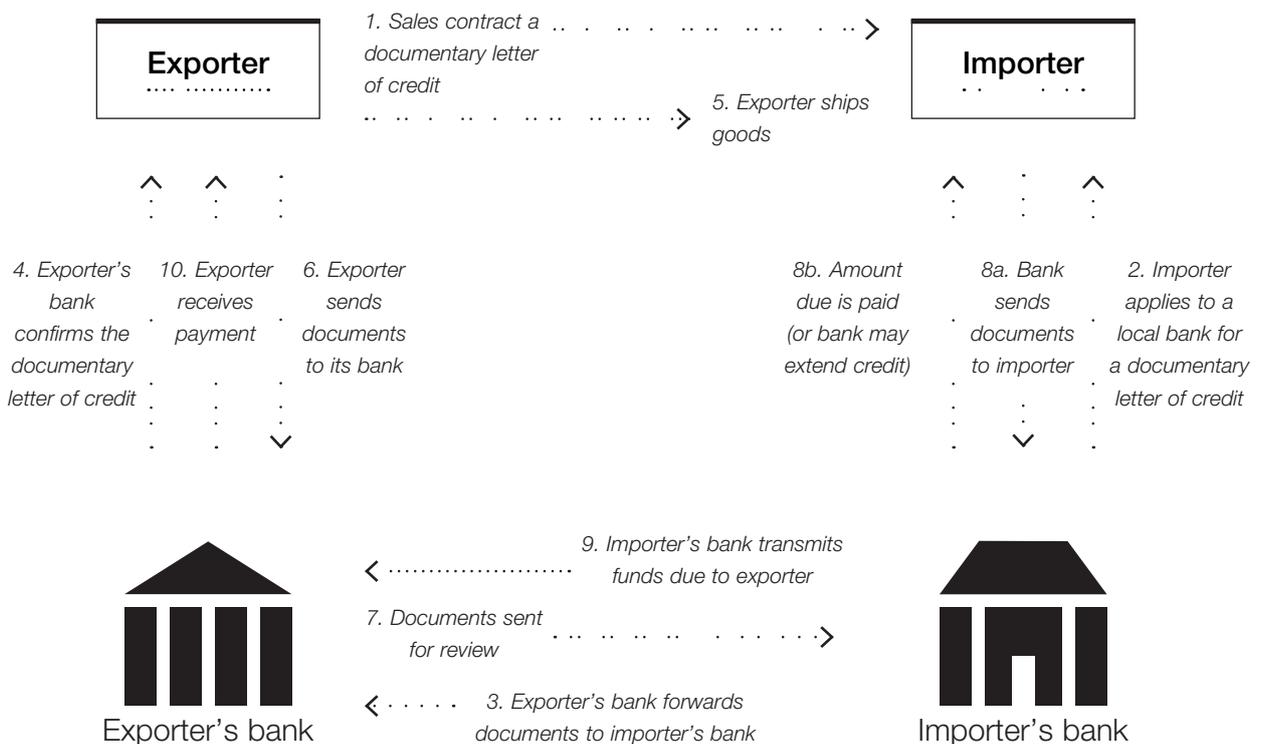
- c) **Bills of Exchange** – a bank acts as an agent for the exporter and their representative releases the exports when the importer meets all the conditions laid down in the shipping documentation. Bills of exchange are particularly useful because strict international laws have been developed governing their use.

Figure 18 Bill of Exchange



d) **Letter of Credit** – The Importer’s bank guarantees payment to the exporter if the exporter meets the conditions laid out in the letter of credit from the bank. This method reduces risk for both the importer and the exporter as a bank is normally much more secure and trustworthy than an overseas buyer.

Figure 19 Letter of Credit



## 2. Hedging

Hedging is the process of minimising the risk of financial transactions. The exchange rate changes constantly and consequently there is uncertainty for business transactions where a time lag exists between contracts being made and payment is greater than 2 days. A hedge is used to reduce any substantial losses or gains suffered by an individual or an organization. When people decide to hedge, they are insuring (protecting) themselves against a negative event.

To avoid this risk a business can hedge. A business can hedge by purchasing a financial instrument such as derivatives to lock in exchange rates or the price of commodities at today's rate to guard against adverse price fluctuations in the future. Hedging tools (derivatives) require establishment costs/ commissions.

## 3. Derivatives

A derivative is a contract between two or more parties whose value is based on an agreed-upon underlying financial asset, index or security. Derivatives are used for speculating and hedging purposes.

Derivatives are financial instruments available to spread the risk of exchange rate fluctuations.

3 types are:

- Forward cover – a contract one currency for another at an agreed rate on a future date. (locks in the price of the currency for future use)
- Currency options – gives the buyer the right without obligation to buy or sell a nominated amount of foreign currency before or on an agreed date at a contract rate in return for a premium paid to the bank upfront.
- Swaps – an agreement to exchange currency during a specified period of time.

## Exercise 2.6 Matching

Match the following statements with the correct terms below

1. A type of hedging tool	
2. Spreading expenses over the whole year	
3. A strategy designed to reduce investment risk in financial transactions	
4. Provides the right to buy or sell an exchange rate at a fixed price	
5. Element of a business where costs are separately figured.	

**Word Bank:** Hedging, Derivative, Cost Centre, Option, Distribution of payments

## 5. Effectiveness of Financial Management

The finance function can be evaluated by 5 indicators (objectives).

**Liquidity** measures a business's ability to repay its short-term debts. The business must have a sufficient cash flow to pay the day-to-day expenses such as purchase of raw materials, payment of wages and salaries, rent, electricity bills, etc. It also enables the business to take advantage of opportunities such as getting cash discounts on purchases, large-scale purchasing and giving credit to customers.

**Profitability** is the ability of a business to make a financial return from its business activities. It is achieved by increasing revenue and or decreasing costs. Businesses need a satisfactory level of profits to survive. Profit helps protect the business against risks such as increasing competition and an economic downturn. Profits are also the main sources of finance for the growth of a business.

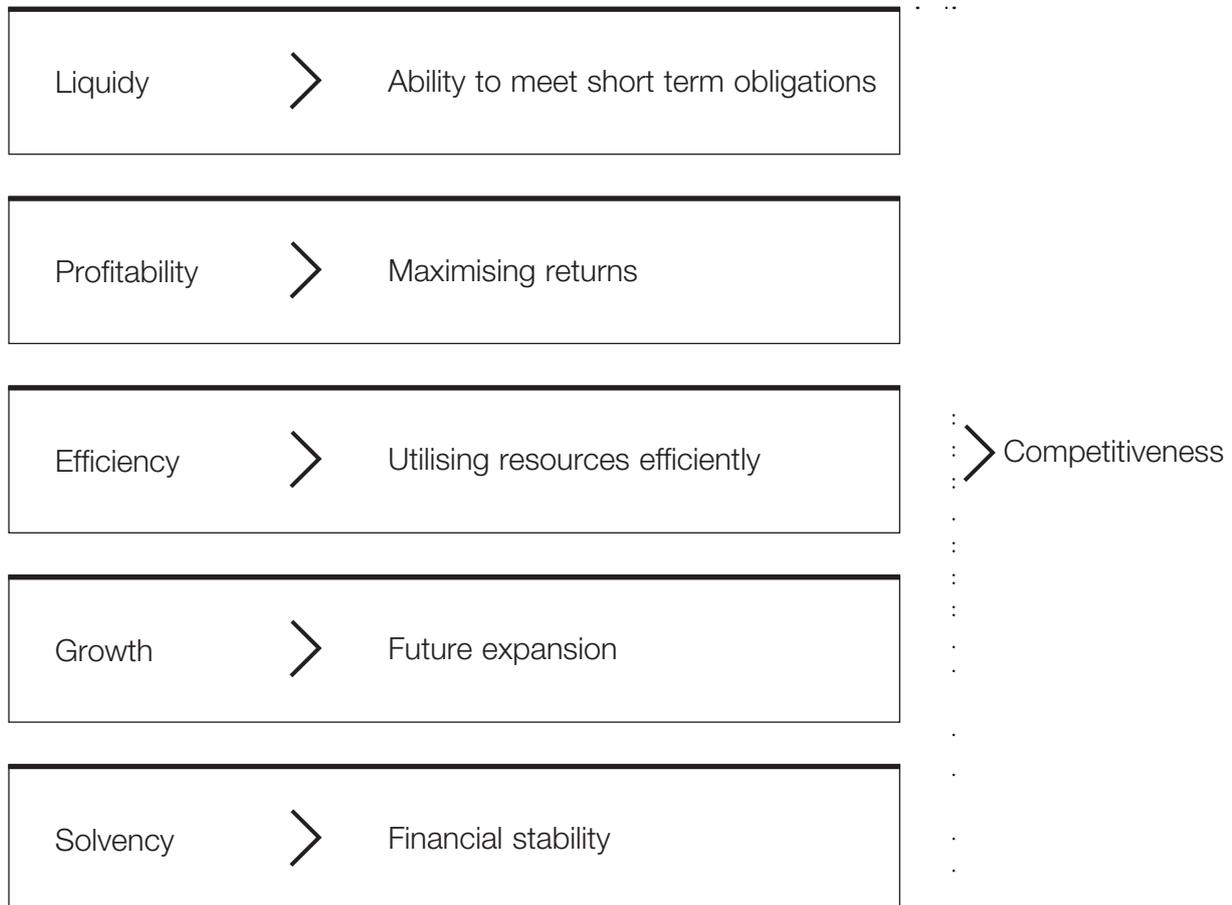
**Efficiency** refers to the ability of a business to manage its assets to generate income.

**Growth (expansion)** refers to the increase in the size and value of a business in the long term. Growth is important because it helps maximise shareholders returns. Growth can be achieved by diversification, mergers and takeovers.

**Solvency** is the ability of a business to continue operations in the long term (financial stability). Solvency indicates the financial risk to which a business is subjected, since excessive debt can

lead to financial difficulties. Too much gearing increases the cost of finance and the amount of income committed to interest repayments and the risk of business failure.

**Figure 20 Effectiveness of Financial Management**



### Exercise 2.7 Multiple Choice

Select the alternative A,B,C or D which bests answers the question.

- Which of the following are profitability management strategies?
  - Factoring, marketing objectives and cost centres
  - Fixed and variable costs, distribution of payments and expense minimisation
  - Cost centres, marketing objectives and expense minimisation
  - Factoring, distribution of payments and leasing

- 2 Which of the following are non-government financial institutions that influence financial management?
- (A) Investment banks, finance companies, ASX and ASIC
- (B) ASIC, ASX and ACCC
- (C) Investment banks, finance companies, unit trust and ASX
- (D) Superannuation funds, life insurance companies and ASIC
- 3 Which of the following are strategies used by businesses to improve cash flow?
- (A) Leasing, sale and lease back
- (B) Distribution of payments, discount for early payment, factoring
- (C) Factoring, leasing, sale and lease back
- (D) Distribution of payments, discount for early payment, leasing

Use the following information to answer questions 4 and 5. The answers have been rounded to the nearest whole number.

*Springbok Computers Ltd has recorded the following figures as at 30 June 2023*

	2023 (\$)
Cash	20 000
Accounts Payable	15 000
Net Profit	23 000
Mortgage	190 000
Capital	75 000
Property	230 000
Accounts receivable	12 000
Equipment	35 000
Overdraft	7 000
Inventory	8 000
Drawings	5 000

Return on Equity Ratio = Net profit ÷ total equity

Current Ratio = Current Assets ÷ Current Liabilities

- 4 What is the return on total equity?
- (A) 24.7%
  - (B) 32.9%
  - (C) 57.5%
  - (D) 86.6%
- 5 Which of the following describes the liquidity of Springbok Computers Ltd?
- (A) The firm is not liquid, with \$1 in current assets to cover \$1.8 of current liabilities
  - (B) The firm is liquid, with \$1.8 in current assets to cover \$1 of current liabilities
  - (C) The firm is not liquid, with \$1 in current assets to cover \$1.39 of current liabilities
  - (D) The firm is liquid, with \$1.39 in current assets to cover \$1 of current liabilities
- 6 Which of the following methods of payment represent the highest risk for exporters?
- (A) Payment in advance
  - (B) Letter of credit
  - (C) Clean payment
  - (D) Bill of exchange
- 7 Which of the following are sources of short-term debt finance for a business?
- (A) Overdrafts, factoring and leasing
  - (B) Unsecured notes, mortgages and debentures
  - (C) Overdrafts, factoring and commercial bills
  - (D) Factoring, commercial bills and leasing
- 8 Which of the following is the government body which enforces and administers the Corporations Act?
- (A) FWC
  - (B) ASIC
  - (C) ASX
  - (D) ACCC

- 9 An exporting business has just signed a contract for delivery of goods in 6 months. Management is expecting the currency to depreciate significantly in this time.
- Which global financial management strategy should the business employ to minimise financial risk?
- (A) Insurance
- (B) Derivatives
- (C) Clean Payment
- (D) Bill of exchange
- 10 An allotment of shares and or debentures made directly from the company to investors is known as what type of equity finance?
- (A) Placements
- (B) Share purchase plan
- (C) Rights issue
- (D) Unsecured notes

Use the following information to answer questions 11 and 12. The answers have been rounded to the nearest whole number.

*Income statement for Dingo Pty Ltd*

	2023 (\$)
Sales	350 000
COGS	90 000
Net Profit	180 000

Gross Profit Ratio =  $\text{Gross Profit} \div \text{Sales}$

Net Profit Ratio =  $\text{Net Profit} \div \text{Sales}$

Expenses Ratio =  $\text{Expenses} \div \text{Sales}$

- 11 Which of the following statements is true?
- (A) The net profit ratio is 54%
- (B) The net profit ratio is 50%
- (C) The gross profit ratio is 74%
- (D) The gross profit ratio is 69%

12 What is the expense ratio for Dingo Pty Ltd in 2023?

- (A) 23%
- (B) 51%
- (C) 26%
- (D) 44%

13 Solvency is the ability of a business to

- (A) meet short-term financial commitments
- (B) maximise profits
- (C) increase its market share
- (D) meet long-term financial commitments

Use the table below to answer question 14.

*Profitability ratios for Chairs Warehouse*

Year	Gross Profit Ratio	Net Profit Ratio	Expenses Ratio
2022	80%	20%	60%
2023	80%	10%	70%

Industry Averages for 2023:

Gross Profit Ratio: 80%

Net Profit Ratio: 20%

Expenses Ratio: 61%

14 Which of the following statements is true about efficiency for Chairs Warehouse in 2023?

- (A) It is better than industry average and has improved since 2022.
- (B) It is worse than industry average but has improved since 2022.
- (C) It is better than industry average and has worsened since 2022.
- (D) It is worse than industry average and has worsened since 2022.

- 15 Which of the following groups would suffer the worst financial impact as a result of an increase in the value of the Australian dollar?
- (A) Australian producers selling beer to America
  - (B) Chinese shareholders of an Australian bank
  - (C) Australian TV makers purchasing inputs from Italy
  - (D) New Zealand travel agents organising tours for Australians

**Exercise 2.8 (12 marks)**

*Mango Airlines Ltd is a new airline in Australia which aims to differentiate itself from its competition by offering a higher quality service and more choice of flights than any other airline. The airline is aiming to expand its operations and requires \$40 Million to achieve their strategic financial goals.*

- (a) Outline the strategic role of financial management. 2

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- (b) Why are interest rates an important financial consideration for Mango Airlines Ltd? 2

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**Exercise 2.9 (8 marks)**

(a) The table shows an extract from a cash flow statement for a business.

	March	April	May	June	July	August
Cash in (\$)	10 000	6 000	2 000	3 000	6 000	6 000
Cash out (\$)	5 000	4 000	8 000	10 000	2 000	2 000

The opening cash balance for March is \$3 000

(i) Calculate the closing cash balance for August. 1

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(ii) In which month did the business end with a negative cash balance? 1

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(b) Outline ONE financial institution available to businesses when looking to finance their operations. 2

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## Answers to Exercises

### Exercise 2.1

1. False, 2. True, 3. False, 4. False, 5. True

### Exercise 2.2

1. False, 2. False, 3. True, 4. True, 5. True

### Exercise 2.3

1. False, 2. False, 3. True, 4. False, 5. True

### Exercise 2.4

1. True, 2. False, 3. True, 4. False

### Exercise 2.5

1. Normalised earnings, 2. Audit, 3. Gearing, 4. Budget, 5. Drawings

### Exercise 2.6

1. Derivative, 2. Distribution of payments, 3. Hedging, 4. Option, 5. Cost Centre

### Exercise 2.7

1. C, 2. C, 3. B, 4. A, 5. B, 6. C, 7. C, 8. B, 9. B, 10. A, 11. C, 12. A, 13. D, 14. D, 15. A

### Exercise 2.8

(a) Answers could include: Strategic refers to the long term and the consideration of the whole business. Financial management is the planning and monitoring of a business's financial resources. Therefore the strategic role of financial management is to ensure that a business achieves its long term goals and objectives, achieved by managing the business's finances effectively.

b) Answers could include: Interest rates are an important financial consideration for Mango Airlines as in their expansion plans they need to be mindful of the potential for interest rate increases which would lead to increased costs and therefore the potential for reduced profitability. Conversely, interest rates may go down over time which would be advantageous to the business as this would lead to a reduction in expenses and therefore an increase in net profit.

Interest rates could also be an important financial consideration if Mango decide to expand overseas and/or borrow capital in overseas markets. They will need to be mindful of potential interest rate fluctuations as well as the inherent exchange rate risk that comes with sourcing capital from overseas.

c) Answers could include:

Long-term borrowing (mortgage, debentures, unsecured notes, leasing)

Equity – ordinary shares (new issues), private equity

A debenture is issued by a company for a fixed rate of interest and for a fixed period of time. They are used to raise funds from investors and in return there is a promise to make regular interest payments for a defined term and at maturity the loan will be repaid. Debentures are generally secured over the company's assets. This is an appropriate source of finance for Mango's expansion overseas as it is a long-term source that could be secured over the assets of the business. An unsecured note is an alternative source of finance. This is a loan from investors for a set period of time. Unsecured notes are not secured over assets of the company and therefore attract a higher rate of interest. Mango may utilise this source of finance however they would need to be aware of the high rate of interest and the impact of this on their overall profitability. Leasing is another source of external finance available to Mango. Given they are in the airline business, leasing is an attractive option as they could make regular payments in return for the long-term use of a fleet of planes. Further to this, the lease payments would be a tax deduction and it would free up capital to be used in other areas of the expansion. The use of a mortgage is one further external source of finance that Mango could use. A mortgage is a long term loan, sourced through a bank (generally) that is used to purchase property. A mortgage has a lower rate of interest payable due to it being secured to a property. This source of finance is only appropriate for Mango if their expansion relates to a property acquisition. A new issue of ordinary shares involves selling shares in a company in the primary market for the first time. This would require ownership of Mango to be given up in exchange for this source of capital. The access to capital would assist Mango's expansion plans.

d) Answers could include:

Hedging

Derivatives

Hedging helps to reduce the level of uncertainty involved with international financial transactions and currency fluctuations specifically, by using financial instruments known as derivatives to lessen the exporting risks associated with currency fluctuations. Currency fluctuations can be a cause of real concern since they can increase costs for businesses and therefore lead to a reduction in profits. A business could hedge by using one of the following three derivatives. A forward exchange contract is a contract to exchange one currency for another currency at an agreed exchange rate on a future date, usually after a period of 30, 90 or 180 days. This means that a bank guarantees the exporter, within the set time, a fixed rate of exchange for the money generated from the sale of the exported goods.

Foreign currency options provide another strategy for risk management. An option gives the buyer (option holder) the right, but not the obligation, to buy or sell foreign currency at some time in the future. Option holders are protected from unfavourable exchange rate fluctuations, yet maintain the opportunity for gain should exchange rate movements be favourable.

A currency swap is an agreement to exchange currency in the spot market with an agreement to reverse the transaction in the future. It involves a spot sale of one currency together with a forward repurchase of the currency at a specified date in the future.

### Exercise 2.9

a) Answers could include:

- i. Closing cash balance for August = 5000
- ii. Negative cash balance at the end of June

b) Answers could include:

**Banks** are the major operators in financial markets and are the most important source of funds for businesses. Banks receive savings as deposits from individuals, businesses and governments, and, in turn, make investments and loans to borrowers.

**Investment banks** provide services in both borrowing and lending, primarily to the business sector. They provide a wide variety of different types of loans for businesses and can therefore customise loans to suit the business's specific needs.

**Finance companies** are non-bank financial intermediaries that specialise in smaller commercial finance. They provide mainly short-term and medium-term loans to businesses through consumer hire-purchase

**Life insurance** companies are also non-bank financial intermediaries who provide cover and a lump sum payment in the event of death. Life insurance companies provide both equity and loans to the corporate sector through receipts of insurance premiums, which provide funds for investment. The funds received in premiums, called reserves, are invested in financial assets.

**Superannuation** funds provide funds to the corporate sector through investment of funds received from superannuation contributions. Superannuation funds are able to invest in long-term securities as company shares, government and company debt because of the long-term nature of their funds due to the compulsory contributions as outlined by government.

**Unit trusts** (also known as mutual funds) take funds from a large number of small investors and invest them in specific types of financial assets. Unit trusts investments include the short-term money market (cash management trusts), shares, mortgages and property, and public securities.

The **Australian Securities Exchange (ASX)** is the primary stock exchange group in Australia. The ASX is a market where shares are bought and sold. It oversees compliance with its operating rules and promotes standards of corporate governance among Australia's listed companies. It operates a primary and secondary market for share trading.

c) Answers could include:

**Factoring** is a short-term source of borrowing for a business. It enables a business to raise funds immediately by selling accounts receivable at a discount to a firm that specialises in collecting accounts receivable (a finance or factoring business). Factoring is an important source of short-term finance because the business will receive up to 90 per cent of the amount of receivables within 48 hours of submitting its invoices to the factoring company. By having immediate access to funds, the business will improve its cash flow and gearing. The business does not have to worry about the collection of accounts or the costs involved in this process. However, it must be remembered that the full amount will not be received for accounts.

### Exercise 2.10

- a) Sample Answer: It is difficult to accurately estimate the value of assets of a business as some assets depreciate and others appreciate. Accountants are allowed to depreciate assets based on accounting standards due to wear and tear but the amount of depreciation is subjective. This creates 'grey areas' that businesses can exploit to create a misleading impression of their financial position, which limits the usefulness of financial reports.
- b) Sample Answer: A rights issue is an issue of shares by a company to its existing shareholders in proportion to their holding of old shares.
- c) Answers could include: revenue controls – marketing objectives; cost controls – fixed and variable costs, cost centres and expense minimisation.

**Revenue Control – Marketing Objectives:** By setting marketing goals eg specific sales targets for the burger business; or introduction of a new product a business can work to increase sales. A new product may draw the attention of new customers and encourage them to buy the business's products. This will increase revenue as also profit levels, especially if price is set carefully.

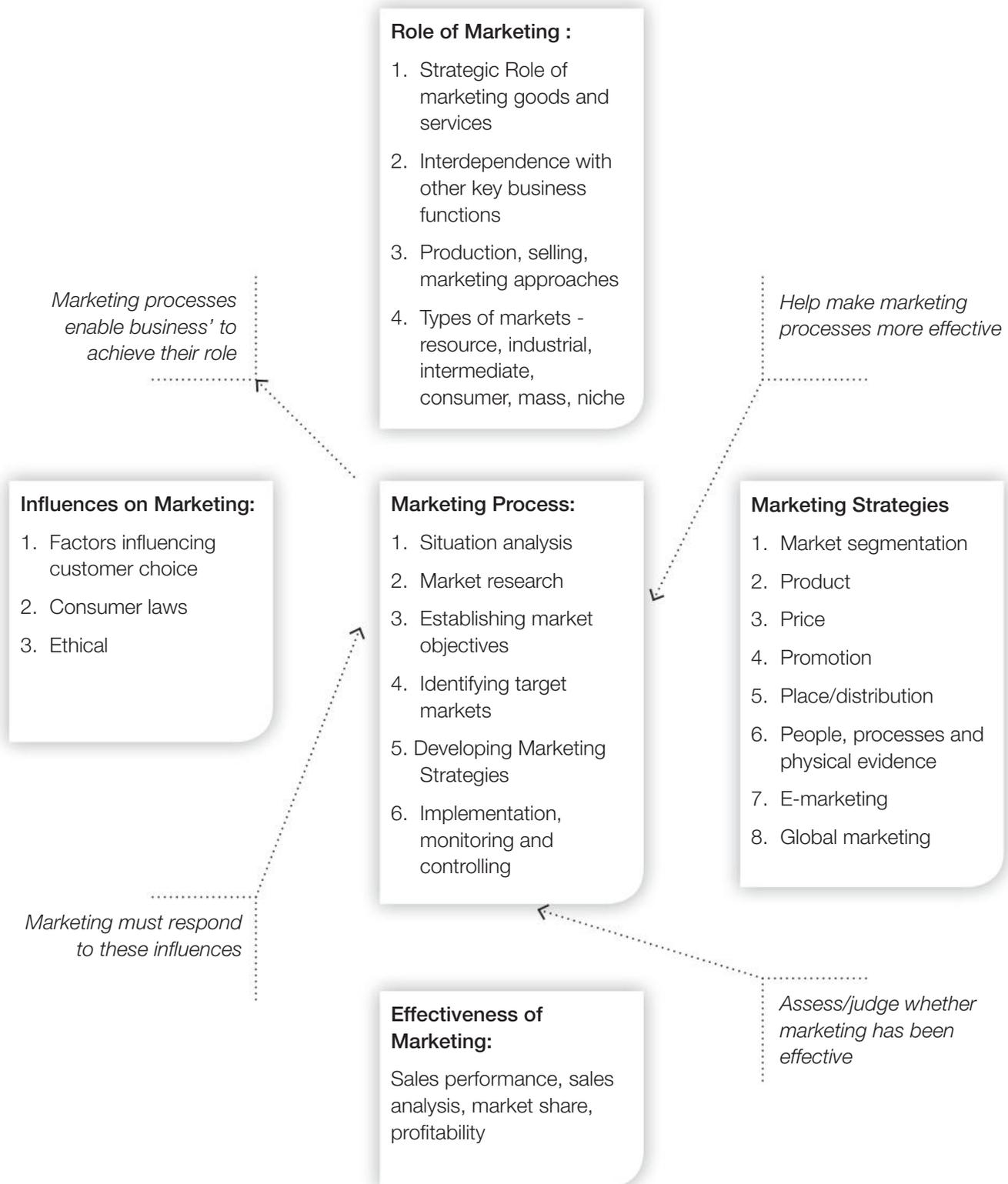
**Cost Control – Expense Minimisation:** In order to improve profitability, a business could focus on reducing costs (the cost of raw materials or labour costs) which are not necessary or can be avoided through expense minimisation. The business should review their costs and work to reduce them through strategies such as negotiating with suppliers for better deals. This will improve the margin for profit on each sale made.

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# Chapter 3

## MARKETING

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## 1. The role of Marketing

### A. The strategic role of marketing goods and services

The strategic role of marketing goods and services is the long-term process of implementing a marketing mix which includes product, price, place and promotional strategies to satisfy the needs and wants of present and potential customers which will enable the business to increase sales and market share and achieve long term profit maximisation.

Part of the strategic role is to develop a SMART marketing plan. The business plan is the road map and the marketing plan are signposts showing the direction.

Marketing is the only business function that generates revenue.

- Its role is to satisfy customer needs and wants.
- It's a major link between the business and its target market.
- It gives the business direction and helps manage a changing environment by continually researching customers.
- It involves a process of exchange (the seller requires payment to satisfy the buyer's need).

### B. Interdependence with other functions

Marketing must be performed in coordination with other business activities. It is crucial to all other functions as it generates future funds needed by the other functions.

The decisions and actions of other functions affect the task of marketers.

- Finance  
Finance depends on marketing to generate funds.  
Marketing strategies are expensive and need to be funded.
- Operations  
Marketing determines the design (differentiation) that operations makes.  
Operations may constrain marketing by establishing physical limits.
- Human Resources  
Marketing determines the type and amount of staff that must be employed by HR to create the good/service that is desirable by consumers. Marketing relies on HR to provide it with the staff it requires to market its goods and services.

## C. Marketing Approaches:

An approach is a method-it's a perception of how marketing should be done or an explanation of why marketing is done in a particular way. Overtime approaches to marketing have changed because environmental factors have changed overtime e.g. competition, consumers.

The 3 approaches to marketing are:

### 1. *Product-based (production approach):*

- from about 1850's-1920's
- focus was on production through improvements in efficiency (bringing out the highest quality product or lowest cost).
- little regard for consumer needs/selling was now secondary.
- beginning of industrial revolution/ mass production/ demand greater than supply/ well made goods were scarce.
- marketing consisted of simply taking orders and delivering products.

It focuses on the strengths of the business rather than the customer.

Today, due to increased competition and choice for consumers, this approach is less viable.

### 2. *Sales (selling approach):*

- 1920's-1960's
- History: During the time of depression, there was overcapacity, supply > demand, lots of competition, this resulted in the hard sell approach.
- The focus was on sales – to sell what the company made.
- It was developed in the USA.
- The predominant factor in the marketing mix was the sales force.
- Today, the sales approach is still used extensively in certain industries, particularly insurance, holiday time share and credit cards.

### 3. *Customer (marketing approach):*

- 1960 to present
- Characterised by a customer orientation.
- It's driven to meet customer needs and wants.

- this approach radically changed the nature of marketing by:
  - a) spurred new product development and more diverse products.
  - b) emphasised more market segmentation.
  - c) focused more on communication.
  - d) created more selective and distribution outlets.
  - e) encouraged a lot more market research.

There are three offshoots to the marketing approach:

- a) Customising individual + optimising products and services approach:  
Offering a customised range of products (non-standard)
- b) Competitor orientation:

Still meet customer needs but monitoring competitors to ensure a sustained competitive advantage. This approach has risen because increased competition, various downturns in the economy and a lot of acquisitions and mergers. Businesses don't want to be out-manuevered.

- c) Relationship marketing:

This is defined as the establishment and maintenance of long term relationships with customers to create customer loyalty. The business is wanting the customer to return in the future and repurchase. A business' sales can come from old and new customer's. This approach focuses more on the old customers.

### E. Types of markets:

Marketers focus on the buyers of particular goods and services. A market is a group of people with the desire and ability to buy a specific product. Businesses sell a range of different products to a range of different customers, which means they sell products in a range of different markets. Marketing plans and strategies vary depending of the intended market.

Figure 21 Types of Markets

Type of Market	Characteristics	Examples
Resource	Made up of individuals/groups who engage in all forms of primary production (sale of raw materials). This could include mining, agriculture, forestry and fishing	BHP
Industrial	Made up of all the individuals and organisations who buy goods and services that go into the production of other products	Apple, Toyota
Intermediate	Businesses that buy goods for the purpose of reselling or renting them to others (wholesalers and retailers)	David Jones, Coles
Consumer	Individuals/households who buy goods and services for personal/household consumption rather than for commercial purposes/don't intend to resell them. Can be divided into Mass or Niche markets.	Us
Mass Markets	Large general market for which a business produces a large amount of one particular product. N.B. Due to greater choice, higher personal incomes and customers seeking more individualised products, the mass market has been replaced by segmented or niche markets	Utilities
Niche Markets	Small markets for more specialised goods and services.	Organic barn laid eggs, different magazines, Fox Sports, Burqini

### Case Study BURQINI

The Burqini (body covering swimwear) was designed by Aheda Zanetti the founder of Adilda Pty Ltd. The word is a hybrid of a burka and bikini. It is a great example of a niche market because it is targeted at a small but specific and well-defined segment of the market namely Muslim women who want to dress modestly at the beach in line with Islamic values and codes of dressing.



**Exercise 3.1**

Indicate whether the following statements are true or false.

True / False Questions	True / False
1. Customisation means marketers can gain economies of scale	
2. The selling approach to marketing originated in the United Kingdom	
3. Overtime approaches to marketing have not changed	
4. During the time of the product approach demand was greater than supply	
5. Toyota would be an example of an industrial market	

**2. Influences on Marketing****A) Factors Influencing Customer Choice**

Marketers need to base their strategies upon what they believe drives customers to make decisions (like purchasing a product or gaining a favourable impression of a brand). Each person is motivated by a different set of factors in different ways but there are a number of common ones.

Businesses must understand consumer behaviour to understand why they make certain choices. If businesses are aware of the psychological, sociocultural, economic and government influences they can better predict trends in consumer behaviour and how the consumer might react to marketing strategies.

- Psychological factors – personal characteristics that influence customer choice, relate to the way people think and develop attitudes to certain products. They include motivation, perception, attitudes/lifestyle, personality and self-image.
- Sociocultural – those that come from society and culture i.e. cultural background, family, reference groups and social class.
- Economic – level of income, occupation and level of educational attainment. They influence a business's capacity to compete and a customer's willingness and ability to spend.
- Government – Government policies which regulate the state of the economy (fiscal and monetary policy), age restrictions on alcohol/tobacco, campaigns to target obesity, even water restrictions.

## B) Australian Consumer Laws

Businesses must ensure that they adhere to Consumer Laws to avoid hefty fines and penalties etc. Consumer protection laws which were found in the Trade Practices Act 1974, have been replaced by the Competition and Consumer Act 2010 (CCA) and are enforced by the ACCC (Australian Competition and Consumer Commission). Consumer laws are used in an effort to discourage unfair practices and to encourage competition in the market place.

The CCA is designed to:

- Protect consumers from undesirable business practices;
- Regulate practices that restrict competition.

Consumer Laws:

- Deceptive and Misleading Advertising – creating a false impression in an attempt to influence consumers. This rule applies to a business's advertising, their product packaging, and any information provided to consumers by their staff or online shopping services. It also applies to any statements made by businesses in the media or online, such as testimonials on their websites or their social media pages.

### Case Study RIBENA

The Ribena case was one of the worst instances of deceptive and misleading advertising. Their advertisements claimed the blackcurrant in Ribena had 4 times the vitamin C of oranges. In fact, the ready to made drink contained no detectable level of Vitamin C. This was first discovered by 2 New Zealand school girls during a science experiment.

- Price Discrimination – setting of different prices for a product in separate markets. The Competition and Consumer Act prohibits price discrimination if it could be proven to substantially reduce competition. Price discrimination is legal in some circumstances. For example, if differences exist in the cost of getting the product to different markets and if there are slight differences in the product itself.
- Implied Conditions – unspoken and unwritten terms of a contract i.e. must be of acceptable quality (acceptable in appearance and finish, free from defects, safe and durable); the product is fit for the purpose for which it is sold. i.e. The unwritten guarantees that the product or service will do the job that it is intended to do.
- Warranties – businesses must state clearly the terms and conditions of the warranty (promise to repair or replace faulty products). A business is required by law to offer a refund if the product is faulty, does not match the description or fails to do the job it was supposed to do.

## C) Ethical Influences

Some critics argue that marketing does not always adopt ethical practices (moral/right or wrong factors beyond legal requirements). They often refer to it promoting materialism, stereotype images of males and females, using sex to sell products and marketing to kids.

NB there are advantages (bottom line) to being ethical.

### 1. Truth and accuracy in advertising

Misleading advertising is illegal, but there are grey areas and loopholes such as the use of terms like special, low fat etc. The main unethical practices with advertising are:

- Untruths due to concealed facts (purposefully omitted)
- Exaggerated claims
- Vague statements (ambiguous language)
- Invasion of privacy (e.g. Tracking of web users)

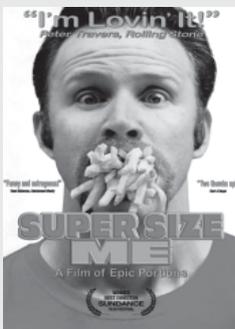
### 2. Good taste in advertising

Can be very subjective i.e. some consumers might find the advert offensive and others may not. In Australia the Australian Standards Bureau self regulates advertising to ensure acceptable standards.

### 3. Products that may damage health

Laws apply to some products like cigarettes. Other products that may damage health include junk food (obesity), premixed alcohol drinks (binge drinking) and gambling.

## Case Study SUPER SIZE ME



*Super Size Me* is a American documentary film directed by and starring Morgan Spurlock. Spurlock's film follows a 30-day period during which he ate only McDonald's food. The film documents this lifestyle's drastic effect on Spurlock's physical and psychological well-being. As a result Spurlock gained 11.1 kilograms, a 13% body mass increase, increased his cholesterol, and experienced mood swings, sexual dysfunction, and fat accumulation in his liver.

The reason for Spurlock's investigation was the increasing spread of obesity throughout U.S. society. The film explores the fast food industry's corporate influence, including how it encourages poor nutrition for its own profit.

#### 4. Engaging in fair competition

There are laws that aim to ensure fair competition, but there remain grey areas and loopholes which firms can exploit. Substantial competition exists for many businesses which means there is a temptation for businesses to act illegally or unethically. The ACCC regulates business behaviour. Examples of unfair competitive behaviour include:

- Price fixing (Large fuel companies agreeing to charge a similar price to drive out smaller competition).
- Long term loss leader (large chains temporarily setting unrealistically low prices to drive smaller competitors out of the market e.g. Coles and Woolworths – sale of home brand milk and bread).
- Misleading advertising regarding a competitor. (Advertising campaigns that make misleading allegations or misrepresentations about competitors. E.g. The ACCC claimed that the NSW Taxi Council made misrepresentations in their adverts about Uber).

#### 5. Sugging

Pretending to sell under the guise of a market research survey. This is a marketing ploy whereby a salesperson pretends to be conducting market research, but is in reality trying to sell a good or service. Sugging is not illegal but is considered unethical. The ethical issues raised include: the invasion of privacy and the deception.

#### Exercise 3.2

Indicate whether the following statements are true or false.

True / False Questions	True / False
1. Truth and accuracy in advertising is a legal influence on marketing	
2. Price discrimination is illegal if it could be proven to substantially reduce competition	
3. Sugging is legal and ethical	
4. A warranty is the unwritten guarantees that the product or service will do the job that it is intended to do	
5. Personality and self-image are psychological factors influencing customer choice	

### 3. Marketing Processes

A company needs a marketing plan for each product it markets. Planning is important managerial activity for all support services including marketing. A marketing plan is a system of organising the marketing of a firm through clear objectives and decisions on including budgets for expenditure and revenue. There are a number of steps/elements in a Marketing Plan.

Elements (steps) of a Marketing Plan include:

#### A) Situational Analysis

This is a preliminary evaluation of the market for the product or service (understanding of the businesses current position). i.e WHERE ARE WE NOW?

It includes:

1. Identify market characteristics/opportunities through a SWOT analysis.
  - Strengths and weaknesses are internal influences (business has control),
  - Opportunities and threats are external influences (business has no control)
2. Product lifecycle

This is the stages a product moves through each life. There are 4, each have certain characteristics. At each stage of the products life cycle a different marketing strategy is necessary.

**Figure 22 Product Life Cycle**

Stage in PLC	Characteristics	Possible marketing strategy
Introduction	Slow sales, profit negative, new product	Promote heavily to increase customer awareness, price may be lower to gain a foothold
Growth	Sales rapidly increase, profit grows quickly, number of competitor's increase	Encourage brand loyalty, promotion seeks a wider audience, increased distribution channels
Maturity	Sales level off, markets saturated, profits start to fall	Redesign packaging, new product features to differentiate the product
Decline	Sales fall, product is outdated. A new product may have replaced it, profits negative eg VCR	Narrow distribution channels, promotion discontinued

## B) Market Research

Market Research is the process of systematically processing, recording and analysing information concerning a specific marketing problem.

Marketing strategies perform best when they are based on accurate, up to date, detailed and relevant information- which places the business in a stronger position. The same goes for a well- researched assessment task.

Releasing a new product is risky. For every successful launch there are at least four which fail. Market research attempts to identify and outline marketing opportunities and problems as well as evaluating the implementation of the marketing plan. It is an intermediate rather than continual source of marketing information. To obtain information marketers use a three step approach.

### 1. *Determine Information needs*

Information must be relevant. You don't want too much, and you don't want too little. You need to weigh up the costs of collecting information against the benefits it provides. The best method to determine the relevance of data is to consistently ask questions regarding its usefulness.

### 2. *Marketing Data (data collection)*

Marketing data refers to the information, usually expressed as facts and figures, relevant to the refined marketing problem. There are 2 types of data collection:

#### a) Primary data

These are facts and figures collected from original sources for the purpose of a specific research problem. The main advantage of primary data is that the information collected is directed at solving a specific marketing problem. Types of primary data collected include:

- Surveys (asking questions) e.g. personal interviews, questionnaires, focus groups
- Observations (recording customer behaviour) e.g. personal observations, electronic (counting machines i.e. road lines)
- Experiment (altering factors under controlled conditions – work out effects) and trials.

#### b) Secondary data

This is information which has already been collected by some other person or organisation. Examples of secondary data include:

**Figure 23 Secondary Data Sources**

Internal data	External data
Research reports	ABS magazines
Financial statements	Private data collection firms
Annual reports	Government reports
Sales figures	Industry reports
Customer feedback	
Management reports	

### 3. *Data Analysis and Interpretation*

Once data has been gathered, conclusions need to be drawn. Statistical interpretation analysis is the process of focusing on the data that represents average, typical or deviations from typical patterns. The business must tabulate and cross tabulate to draw conclusions.

#### C) Establishing market objectives

- Marketing objectives are the same as marketing goals
- They are derived from the objectives in the overall business plan.
- They guide marketing activities
- They are constantly updated/changed due to changes in the environment
- Marketing objectives need to be SMART (Specific, Measurable, Achievable, Realistic, and Timed)
- There are 4 main types of marketing objectives:
  - (1) Sales volume
  - (2) Market share (proportion that product has in relation to the total market of the product or service)
  - (3) Profitability
  - (4) Additional objectives stated in terms of the marketing mix ie increase product range or geographical representation or distribution outlets or customer service etc.

#### D) Identifying Target Markets

A target market is that group of buyers with similar characteristics to whom the marketing strategies are directed. This is done through a process of market segmentation. More

information on target markets will be provided at the beginning of the “Marketing strategies” section.

### E) Developing marketing strategies

There are lots of marketing strategies (again this is covered in detail later):

- 7 P’s
- E-marketing
- Global marketing

### F) Implementation, monitoring & controlling

#### ■ Implementation

This is the process of turning the marketing plans into action. It involves all the activities that puts the marketing plan into work.

#### ■ Monitoring

Checking / observing the actual process of the plan i.e. this involves gathering information. This is known as developing a financial forecast (estimate, projection, budget which becomes the performance standard. This involves:

- a) forecasting / estimating revenue (sales) by statistical models, past sales, data etc.
- b) forecasting expenditure- Marketing costs can be broken down to include research costs, product development costs, promotion costs, distribution costs.

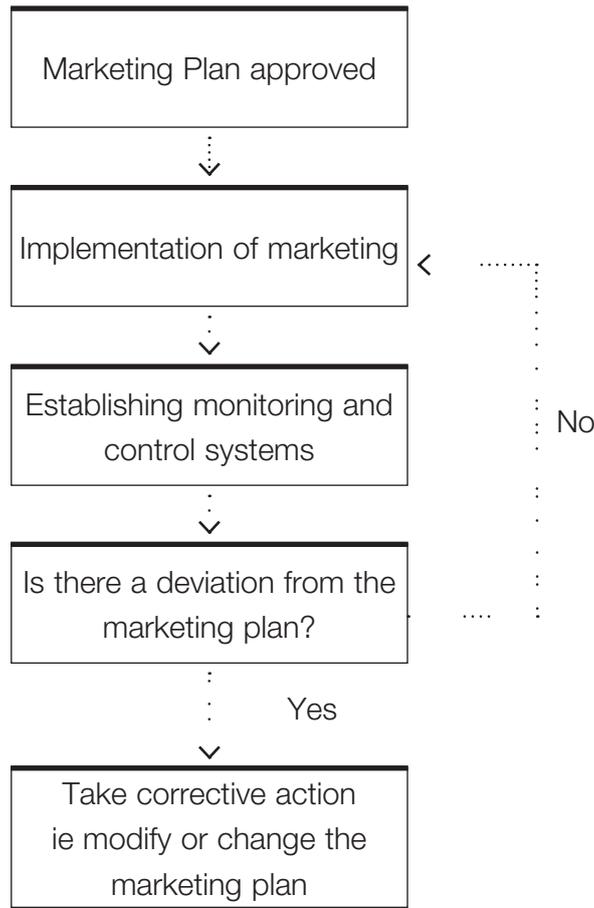
NB: Once you forecast revenue and expenditure it allows you to estimate profit.

#### ■ Controlling

Involves the comparison of planned performance (financial forecast) against actual performance and taking corrective action (revising marketing strategies) if necessary.

- a) Product modifications (upgrading the product, changing packaging etc.)
- b) Price modifications (is the price too high or too low, should you give discounts)
- c) Promotional modifications (change your advertising medium)
- d) Place modifications (finding new outlets, transport, warehousing etc.)

Figure 24 Implementing, Monitoring and Controlling the Marketing Plan



**Exercise 3.3**

Indicate whether the following statements are true or false.

True / False Questions	True / False
1. The first step of the market research process is data collection	
2. At each stage of the PLC a different marketing strategy is necessary	
3. In the maturity phase of the PLC companies seek to rationalise product ranges	
4. Marketers get their planned results from financial forecasts	
5. Once the marketing plan has been implemented it must be monitored and controlled	

## 4. Marketing Strategies

### A) Market segmentation, product/service differentiation and positioning

#### *Market Segmentation and identifying the target market*

Market segmentation is the process of dividing up a very large group of potential or current customers into smaller groups. The reason for segmenting the market is that the business needs to use its scarce marketing resources as efficiently as possible. There is no point spending it on people who can't or won't buy the product. By segmenting the market, a business can direct its marketing strategies to specific customers rather than the total market.

It enables:

- A business to meet the needs of customers, compete effectively and attain financial goals more easily.
- The marketing mix to be better tuned to particular groups in the market.

Market segmentation can be based on:

1. Demographic characteristics  
Segments consumer markets into demographic variables such as age, gender, income, occupation, family life cycle.
2. Geographic segmentation  
Grouping customers according to geographic features such as location, urban, suburban, rural and climate.
3. Psychographic segmentation  
Buyers are segmented into different groups on the basis of lifestyles/personalities/values/motives. People with the same demographic group can exhibit very different psychographic characteristics.
4. Behavioural segmentation  
When the buyer is divided into groups based on their knowledge or attitude towards, or response to a product (according to the customer's relationship with a product). Buyers can be distinguished according to the occasion, benefits derived, user status, user rate, loyalty etc.

#### *Product/service differentiation*

Product/service differentiation is the process of developing and promoting differences between the business's products or services and those of its competitors. Product differentiation involves creating characteristics unique to the product to persuade consumers to purchase its

products rather than a rival product. Businesses can compete for buyers by making its product stand out from its competitors based on certain attributes. Potential points of difference could include: price, packaging, labelling, quality of service, value for money (is the desire to obtain the best quality, features and performance for a given price of a product), convenience, customer service, environmental concerns and social/ethical issues.

### *Positioning*

This refers to the technique in which marketers attempt to create an image or identity for a product compared with the image of competing products. It is how marketers want their product to be perceived by the consumer.

### **B) Product, including branding and positioning**

The product component ensures that the product characteristics provide benefits to the consumer. Components of a product include:

- **Physical characteristics**  
This includes size, shape, colour, features, accessories
- **Psychological & emotional characteristics**  
This is what the product supposedly does e.g. cosmetics make you look younger
- **Branding**  
This is the name, term, symbol and/or special design that is intended to identify the goods or services of the seller- it differentiates one seller's product from a competitor. Businesses use logos, slogans, jingles and the brand name when branding its products.
- **Packaging**  
This involves the development of a container and the graphic design for a product. It includes promoting and protecting the product. It can make the product easier to identify and promote the brand at the point of purchase. It can make the product easier to use or store (prevent damage). Labelling is the presentation of information on the package e.g. ingredients, instructions, shelf life, country of origin etc. Packaging serves a number of important uses in marketing:
  - It protects the product during transportation, on the shelves, during use.
  - It informs the consumer about the use of the product.
  - It promotes the product and distinguishes it from its competitors.
  - It protects against misuse or tampering with the product.
  - It attracts the consumers' attention.

- Post sale support  
Credit terms, delivery installation, warranties and service.
- Series of new products  
Because existing products eventually mature and decline, firms need a series of new products to maintain profits over time. Types of new products include;
  - (1) Innovation: These are products that are new to the consumer and the company.
  - (2) New product duplication: Products known to the market but not to the company.
  - (3) Product extension: Present consumers with a seemingly new product improvement without costly re-development.

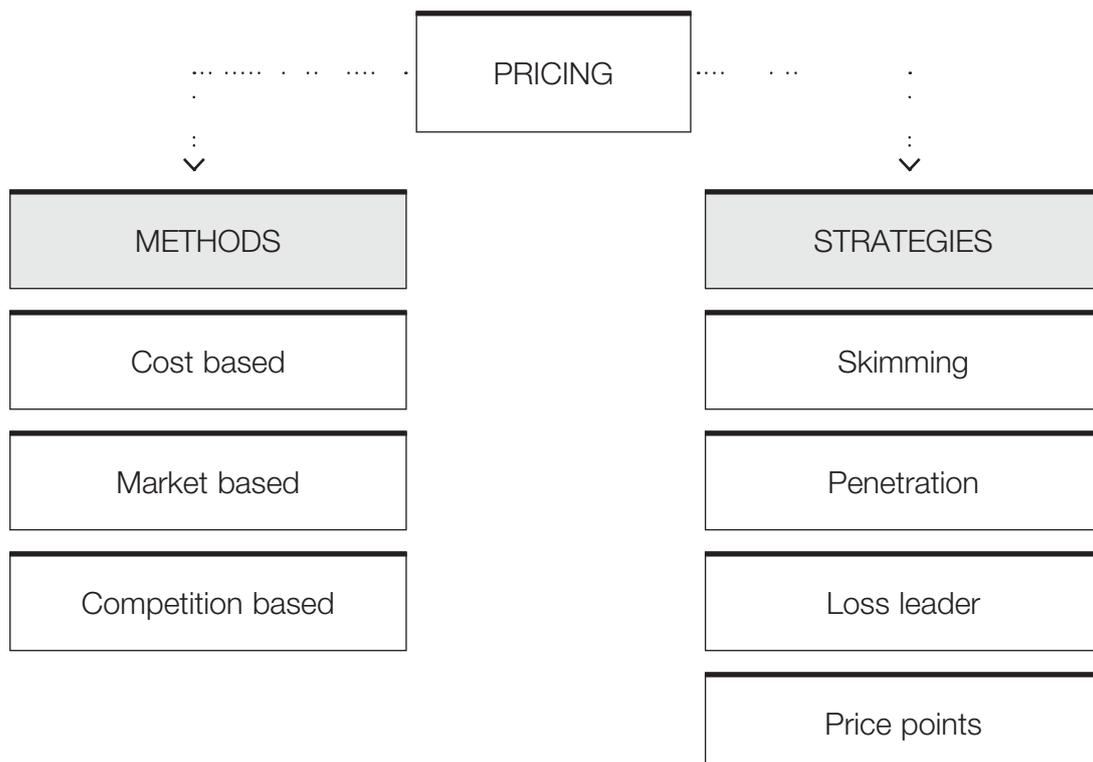
C) Price

The price component ensures the product is priced at a level that reflects customer value.

Price is critical, a price that is too low or too high not only discourages consumers from buying it but also effects their attitudes and perceptions of the product. Price is especially important because it directly affects the number of sales and therefore profit. It's now even more important because:

- (1) Consumers are more price sensitive/conscious and they shop around.
- (2) There is a lot more competition including overseas
- (3) There is much more de-regulation (looser rules) has made the market more competitive

Figure 25 Pricing Methods and Strategies



Businesses set prices by selecting a pricing approach that includes one or more of the following methods:

- a) Cost based pricing: Price is based on the business' cost of production with a mark-up!
- b) Market based pricing: Businesses set the price only in relation to the competitive market price set by the market (i.e. based on supply and demand).
- c) Competition based pricing: Businesses use the prices set by competitors as a guide for their own pricing decisions.
- d) Value based pricing: Basing their prices on the products perceived value by the consumer.

### *Price Tactics / Strategies*

1. *Skimming*: Aims to sell to the top of the market (high price strategy). This would normally be for innovative products where there is little or no competition (limited substitutes) and high demand. An example would be when Apple launched their new Apple watch or when they launched the new iPhone X.

Best thing about skimming:

- Usually the most profitable strategy
- Attracts a prestige image
- Great if demand is inelastic and there is some patent protection

2. *Penetration*: low price strategy. Here a business charges the lowest price possible for a product or service, so that consumers try their product and switch brands. The business is wanting to achieve a rapid increase in market share and brand awareness by consumers. This strategy would be best when there are a number of similar products already entrenched in the market and the business's new product needs to be introduced to consumers. When Virgin Airlines entered the market they sold domestic flights as low as \$23 to entice consumers to try their airline.

Best thing about penetration:

- Great for market share (attracts customers)
- Discourages competition from entering the market
- Can gain economies of scale (savings of cost by selling more)

3. *Loss Leader*: Products which are priced below their cost of production. This is to attract customers to the store and then encourage them to stay and buy other regularly priced products. RSL clubs and bars will often sell food at a loss to entice customers into the venue and then make profit on the drinks they sell. Woolworths and Coles will sell their

brand of milk at a loss to entice customers into the store. They are hoping that once the customer is in the store they will purchase regularly priced items.

4. *Price points*: Psychological price references for consumers which indicate relative quality. Price points (or price lining) is selling products only at certain predetermined prices. The use of price points is a pricing strategy whereby a business sets different prices for similar products. The products are differentiated by their features. This is a pricing strategy used mainly by retailers where a limited number of prices, or price points, are set for selected lines or groups of stock. Qantas airlines – 1st class, business class, premium economy and economy. Hoyts offer Gold Class seats. Apple offer a range of I Phone X.

### *Price and Quality interaction*

Some consumers use price as a guide for judging quality- you get what you pay for. It is also an indication of prestige. The price set for a product must be consistent with its positioning and overall marketing strategy, e.g. value-for-money products cannot have a high price tag. In general, people equate higher prices with higher quality. However, this doesn't apply to all products. Some high price products are no better than medium priced products. It's all in the marketing e.g. wine, washing powder. Prestige or premium pricing is a pricing strategy where a high price is charged to give the product an aura of quality and status.

### **D) Promotion**

The promotion component communicates the products ability to satisfy the needs and wants of the customer. Promotion is the methods used by a business to inform, educate, persuade and remind consumers about its products. The 4 elements of the promotional mix: i.e. Promotional tools used to communicate with the target market are:

- (1) Advertising – Is paid ongoing, non-personal communication from a commercial source e.g. TV, radio, newspaper etc. This type of promotion is usually very expensive but can reach a large target market at a low cost per person. This now includes social media and e-marketing (internet).
- (2) Sales promotion – Short term inducement of consumers to encourage them to buy. This is commonly known as 'below the line' promotions. These promotional activities are mostly designed and developed 'In-House' – by the business itself. These activities could include exhibitions, point-of-sale material, demonstrations, competitions, free samples and coupons, use of banners and ring tones. This type of promotion is used when the target market is specific and easily identified and is a relatively cost effective form of promotion.
- (3) Personal selling – This is usually face to face (can be over the phone or online chat) communication via company representatives to influence the customer to buy its products.

It involves the human aspect of promotion. It is a very expensive method (high wage costs) however:

- The message can be modified to suit the individual customer needs and circumstances.
- Individual assistance can create a long term relationship that can increase future sales.
- The sales representative can provide after-sales customer service in relation to features, installation, warranties etc.

(4) Publicity & Public Relations – Publicity is any unpaid form of publicity (news story or press release, press conference) about a business or its products. This type of promotion is free and not controlled by the business. It may be positive or negative and it carries more weight with consumers as it is considered to be unbiased. Public relations are those activities aimed at creating a favourable relationship between a business and its customers i.e. working with the media, making speeches on special occasions.

### *Communication Process – opinion leaders and word of mouth*

It's important that marketers understand the communication process i.e. how it works so that messages sent out to consumers are as clear as possible e.g. Chinese whispers i.e. consumers are hit with thousands of marketing messages daily- they don't often get it.

Often customers may be more willing to purchase the product if the messages come via a respected and trusted channel.

e.g. 1) An opinion leader (a person who influences others or whose opinions are sought). This could include celebrities or experts in certain fields.

e.g. 2) Word of mouth is personal communication about a product between consumers and their friends, family, associates etc. You trust someone you know or know of.

Why is it important to use a mix of promotional strategies? Each element of the promotion mix has different benefits and therefore a mix will better cater to the entire target market. Each element may also influence the same single consumer in several ways. Each component should be coordinated to make the communication process more effective and therefore achieve marketing objectives.

### **E) Place**

Place is making goods and services available at the right quantities and locations when consumers want them. Place decisions include:

1. Whether to use direct or indirect distribution.

- direct – is to sell products direct to the consumer-no intermediaries e.g. door to door (Foxtel), group selling (Tupperware), company owned outlets, telephone sales, mail order, Internet.
  - indirect – means using Intermediaries i.e. agents, brokers, wholesalers and retailers.
2. Assuming you use intermediaries the next decision is the length and intensity of distribution.

### Length of distribution

This is how many people in the distribution chain.

producer ....> consumer

producer ....> retailer ... > consumer

producer ....> wholesaler .. > retailer .. > consumer

The shorter the chain the more control you have.

### Intensity of distribution (Channel choice)

How a business chooses the channel of distribution best suited to its product depends largely on the location of the business's market or market coverage. Market coverage refers to the number of outlets a firm chooses for its products and will influence the intensity of distribution.

There are 3 intensity channels:

- Intensive: Where the product is available in lots of outlets. Here the business wishes to saturate the market with its product. Many convenience goods such as milk, lollies, soft drinks and newspapers, are distributed this way.
  - Selective: Where the product is available in a moderate proportion of outlets. Clothing, furniture and electrical appliances are often distributed this way. The customer would be prepared to seek out a specific outlet that stocks the goods.
  - Exclusive: Limits the supply of products to one retail outlet (often used for exclusive items). Examples include: MacDonald's, IKEA etc.
3. Physical distribution – this looks at all the activities involved in the flow of products from manufacturer to consumer.
- Transportation: The movement of products by air, rail, water, sea, road, pipe. You need to look at speed, cost size, other things like whether it needs to be refrigerated.
  - Warehousing: The storing of goods, before they are sold. (this includes materials handling).
  - Inventory: Order processing: activities used to handle and fill sale orders.

## F) People, processes and physical evidence

As the service sector has grown so much, these 3 P's have been added.

- People – refers to the interaction between the customer and the business. Business need highly qualified and trained staff. They are the human face. How employees treat customers is very important as customers' perception of the product is impacted by how staff treat them.
- Processes – refers to the flow of activities that a business will follow to deliver a service. E.g. Pizza delivery, booking an airline ticket. Customers will judge the business on how efficient and customer friendly these processes are. A business that has inefficient processes will lose customers and damage its reputation.
- Physical Evidence – refers to the environment in which the service will be delivered. Includes materials such as signage, brochures, letterheads, website, logo, uniform. In a restaurant this would include the menu, lighting, furniture and décor etc.

## G) E-marketing

- Means electronic marketing (using the internet to perform marketing activities). This could include: webpages, SMS, blogs, podcasts etc. SMA (Social Media advertising) is a form of E-Marketing (online advertising) using social media platforms such as Facebook, YouTube and Twitter to deliver targeted commercial messages to potential consumers.
- The advantages of this type of marketing includes: Cost effective, faster response, increased ability to measure and collect data.
- The disadvantages of this type of marketing includes: Lack of personal touch, security and privacy issues.

## H) Global marketing

Global businesses are faced with different market environments. Global businesses adopt a number of marketing strategies. The marketing mix should be customised to take into account differences in culture, religion and tastes from one country to another. This is despite globalisation.

- Global branding – is the worldwide use of a name, symbol, logo to identify the product and distinguish it from its competition (used in all international markets, cost effective, provides a uniform image). Global branding is considered successful if the brand is recognised regardless of the language, social or cultural barriers e.g. McDonald's, Google, Facebook.
- Standardisation – assumes the way the product is used and the needs it satisfies are the same the world over. Therefore the same marketing strategies will be used worldwide. Standardisation is cost effective because you can gain economies of scale in marketing.
- Customisation – adapting (tailoring) the product to meet local consumers' needs and wants.

It is possible to adopt a 'middle path' between standardised and customised global marketing. Macdonalds do this as some of their products are standardise across the globe (Big Mac) and others are customised (Aussie Burger).

- Global pricing – this is how businesses coordinate their pricing policy across different countries. Will a uniform (standard) or customised pricing strategy be used?
  - a) Customised pricing – different prices charged for the same product in different countries. For example, Apple music sell the same songs for different prices in different countries.
  - b) Standard workplace pricing – same price charged for the same product in different countries
- Competitive positioning – relates to how a business will differentiate its products, may be different in global markets. In so doing, develop strategies for the business to create value from these differences. How will the business carve out a place in the competitive marketing environment? A global business must clearly show how it's products are better than the competitors' products. Without differentiation, it takes more time, money and effort to encourage potential customers to purchase a business's products. This is achieved through product differentiation by showing product leadership, developing positive customer relationships and operational excellence in foreign markets.

### Exercise 3.4 Matching

Match the following statements with the correct terms below

1. What is the flow of activities that a business will follow to deliver a service?	
2. Where the product is available at every possible outlet?	
3. Using the internet to perform marketing activities	
4. Using a uniform brand around the world is called?	
5. Using a well-known person to influence consumers to buy their product is called?	

**Word Bank:** Global Branding, E-Marketing, Intensive Distribution, Process, Opinion Leader

## 5. Effectiveness of Marketing

The marketing function can be evaluated by 4 indicators.

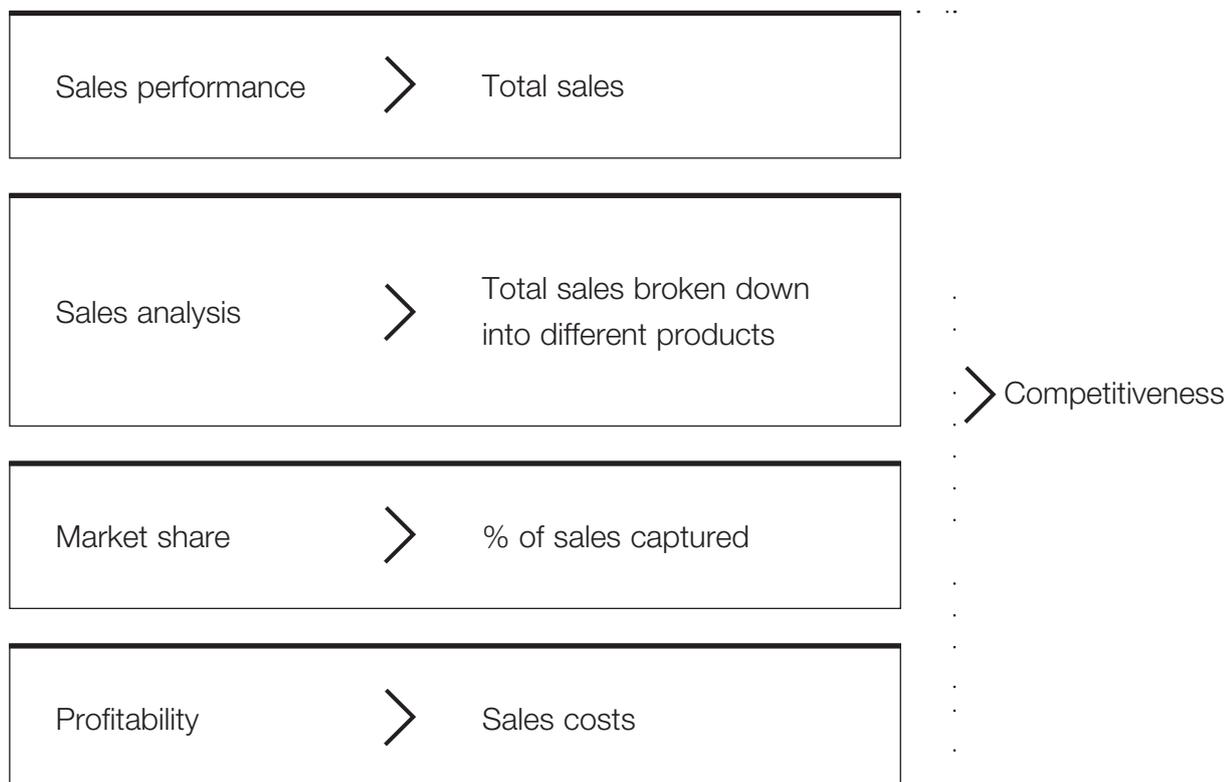
**Sales performance** refers to total sales (sales volume multiplied by unit price). Analysing the difference between total sales and historical and budget sales is useful to measure the effectiveness of marketing strategies. An increase in total sales would indicate that marketing strategies were more effective.

**Sales analysis** breaks down total sales into different products, sales regions etc. Sales analysis gives a much better picture to assess the effectiveness of marketing strategies because most businesses sell many products to a variety of customers, and in many regions.

**Market share** is a popular metric used to detect the effectiveness of marketing strategies. It is the percentage of sales a company wields out of total sales by all competitors. Increasing market share is one of the most important objectives of business. The main advantage of using market share as a measure of marketing performance is that it is less dependent upon external influences such as the state of the economy or changes in government policies.

**Profitability** (revenue – expenses) is one of the primary indicators business use to judge their marketing performance. Increased profitability generally indicates that marketing strategies are more effective.

**Figure 26 Effectiveness of Marketing**



**Exercise 3.5**

## Multiple Choice Questions

Select the alternative A, B, C or D which best answers the question.

1. Which of the following best describes production orientated marketing?
  - a) Increasing production through improvements in efficiency
  - b) Monitoring competitors to ensure a sustained competitive advantage
  - c) Using an aggressive sales force to persuade customers to purchase products
  - d) Offering a customised range of products
  
2. The use of a “Coffee card” by retailer C U Latte provides a free coffee after every fourth purchase. What type of marketing orientation does this demonstrate?
  - a) Selling
  - b) Marketing
  - c) Production
  - d) Relationship marketing
  
3. Peterson’s Department Store purchases goods from other businesses for the purposes of reselling them to the general public. Which type of market is being described?
  - a) Intermediate
  - b) Resource
  - c) Consumer
  - d) Mass
  
4. Julie drinks low fat milk because she believes it is healthier for her? What factor is influencing her choice?
  - a) Economic
  - b) Government
  - c) Sociocultural
  - d) Psychological
  
5. Atlas Pharmacy sends emails to customers from its database to inform them of special offers and competitions. Which elements of the promotions mix is Atlas Pharmacy using?
  - a) Sales promotion and publicity
  - b) Relationship marketing and sales promotion
  - c) Personal selling and relationship marketing
  - d) Publicity and personal selling

6. A manufacturer's claim that its cranberry juice contains Vitamin C has been clinically proven to be false. Which of the following aspects of consumer law has been breached?
- a) Implied conditions
  - b) Price discrimination
  - c) Resale price maintenance
  - d) Deceptive and misleading advertising
7. Kelly decides to carry out a SWOT analysis on part of her marketing process. Which of the following is an example of a threat?
- a) The business fails to meet financial objectives.
  - b) The business has a poor reputation.
  - c) Kelly relies on unreliable technology.
  - d) There is an economic downturn.
8. A product is experiencing brand acceptance, an increase in market share and wider distribution channels. What stage of the product life cycle is this?
- a) Decline
  - b) Growth
  - c) Maturity
  - d) Establishment
9. A company has decided to review its marketing strategy as they have not reached the desired market share. Which marketing process is this an example of?
- a) Monitoring
  - b) Controlling
  - c) Forecasting
  - d) Implementation
10. When would price skimming be an appropriate price strategy to use in a business?
- a) The business is attempting to develop brand loyalty
  - b) Demand is high for an innovative product and there is limited competition
  - c) The business is attempting to attract customers to other products
  - d) The business is able to offer different prices to different users of the product

11. Which of the following could be looked at when segmenting a market by demographic characteristics?
- a) Personalities, gender, age, marital status
  - b) Product use, personality, age, occupation
  - c) Age, gender, religion, nationality
  - d) Personality, age, religion, occupation
12. Which of the following is an ethical rather than a legal issue of marketing?
- a) Price discrimination
  - b) Warranties
  - c) Sugging
  - d) Implied conditions
13. John Dory's chain of Fish Cafés across Australia sell a signature dish on its menu to consumers. Which channel choice is the chain of Café's using to distribute this product to its consumers?
- a) Intensive
  - b) Exclusive
  - c) Selective
  - d) Deceptive
14. The third step in the marketing planning process is?
- a) Market research
  - b) Situational analysis
  - c) Identifying target markets
  - d) Establishing marketing objectives
15. Crawford Lawyers, a large law firm in the Sydney CBD, have developed a dress code for their staff. This dress code, among other details, emphasises the need for staff to be in professional, corporate attire at all times, and have a clean and tidy personal presentation. Which of the following marketing strategies relates to Crawford Lawyers' policy on professional dress?
- a) Processes
  - b) People
  - c) Physical evidence
  - d) Promotion

**Exercise 3.6**

(A) Describe TWO ethical influences on marketing. Use examples to support your answer. 4

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(B) Outline the importance of a situational analysis in marketing. 2

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(C) Describe TWO elements of the promotion mix that a business can use to get their message to their target market. 4

(i) \_\_\_\_\_

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- (ii) \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

### Exercise 3.7

Bronwyn has just started producing a facial cream for the ageing population, however it is very expensive. She plans to market this in a number of ways.

- a) Outline TWO elements of the communication process that might help increase sales of this product. 2

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- b) Describe how price and quality interact in the marketing of goods. 2

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- c) Describe TWO factors influencing customer choice for the facial cream. 2

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- d) Explain how ONE consumer law and ONE ethical concern may influence marketing management of this product.

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**Exercise 3.8**

- (a) Outline the interdependence of marketing with finance.

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- (b) Identify TWO physical distribution issues when marketing a product.

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- (c) With reference to a business you have studied, explain the difference between standardisation and customisation when marketing a product globally.

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## Answers to Exercises

### Exercise 3.1

1. False 2. False 3. False 4. True 5. True

### Exercise 3.2

1. False 2. True 3. False 4. False 5. True

### Exercise 3.3

1. False 2. True 3. True. 4. False 5. True

### Exercise 3.4

1. Process 2. Intensive Distribution 3. E-Marketing 4. Global Branding 5. Opinion Leader

### Exercise 3.5

1A, 2D, 3A, 4D, 5B, 6D, 7D, 8B, 9B, 10B, 11C, 12C, 13B, 14D, 15C

### Exercise 3.6

A) Sample answer: Truth and accuracy in advertising – think exaggerated claims, vague statements, untruths due to concealed facts and Products that may damage health – think digital advertising of junk food to children

B) Sample answer: A situational analysis is a part of market research including; a SWOT and Product Life Cycle. It provides clear information needed to complete the situational analysis and give a clear indication of the business' position compared with its competitors.

C) Sample answer: Elements in the promotion mix include:

- Advertising
- Personal selling
- Relationship marketing
- Sales promotions
- Publicity
- Public relations

### Exercise 3.7

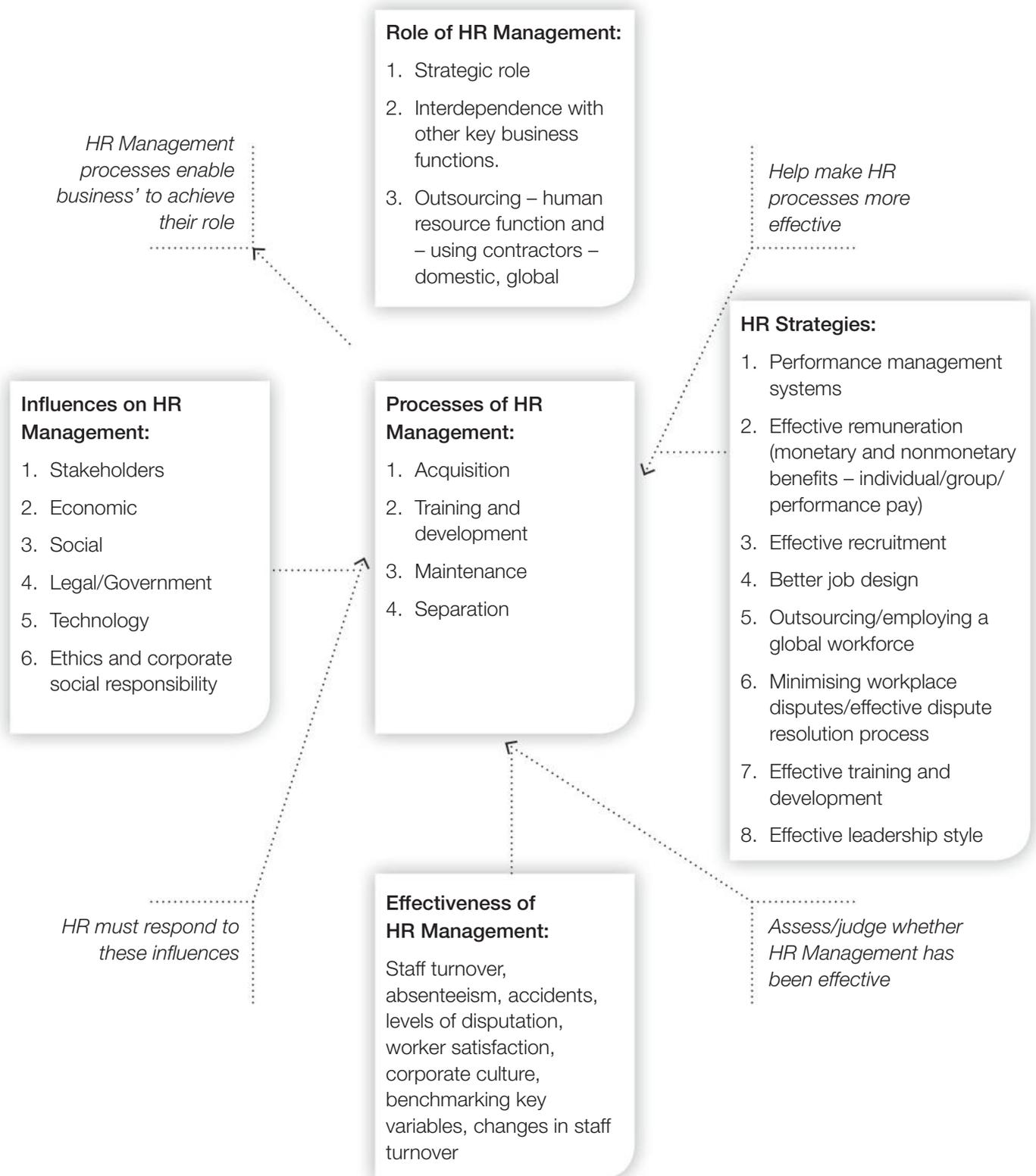
- a) Answers could include: word of mouth, opinion leaders
- b) Answers could include: Products sold at a higher price would tend to be better quality. There is also a perception in customers mind that a higher price means the product will be better quality.
- c) Answers could include: psychological, economic, government, sociocultural
- d) Answers could include: consumer laws (deceptive and misleading advertising, price discrimination, implied conditions and warranties), ethical (truth, accuracy and good taste in advertising, products that may damage health, engaging in fair competition, sugging).

### Exercise 3.8

- A) Answers could include: Interdependence refers to the mutual dependence that the key business functions have on one another. Finance depends on marketing to generate funds and marketing relies on finance for the funds necessary to implement the marketing plan.
- B) Answers could include: Transport, warehousing, inventory
- C) Answer could include: A standardised approach is a global marketing strategy that assumes the way the product is used and the needs it satisfies are the same the world over whereas a customised or local approach is a global marketing strategy that assumes the way the product is used and the needs it satisfies are different between countries. The effect is that a standardised approach to marketing will be more cost effective however it may lead to the business not effectively marketing to their target market. Customisation may in turn assist the business to effectively target their customers however it can be more costly and time consuming. An example of a business that has used a customised approach is Qantas. They offer their customers different food options depending on the origin of the flight and the hosts and hostesses can generally speak English as well as the language of the country from where the flight originates.

# Chapter 4

## HUMAN RESOURCES



## 1. The Role of Human Resource Management (HRM)

### A. The strategic role of Human Resources

The strategic role of HRM is to provide a human resource package that can help meet the business long term objectives. This means making sure that the business has workers that are well suited, trained, and motivated to achieve these objectives. It is therefore responsible for providing and managing the human workers needed for each business activity or function.

- HRM refers to the relationship between the Employer and Employee.
- Modern HRM sees employees as assets, rather than costs and encourages open communications and goal orientation.
- Modern HRM accepts that legitimate differences exist in work places but aims to reduce conflict through effective procedures and relationships.
- Firms with effective employment relation practises manage change more effectively and thus enhance their ability to gain a sustainable competitive advantage.

### B. Interdependence with other key business functions

Because of its central role, human resource management must be performed in coordination with other business activities.

Human resources require funds to remunerate staff as well as funding effective human resource strategies like training and development. Staffing is usually the businesses biggest expense and effective management of staff is essential for businesses to maintain profitability and productivity.

Human resources effects how marketing performs. The right staff must be employed and trained to create the good or service that is desirable by its customers. People are now considered an important part of the marketing mix.

The efficiency of operations is affected by the quality of its human resources. Also the use of new operational technology requires staff to be trained. Operational changes like outsourcing and downsizing changes the size and type of the workforce.

### C. Outsourcing

Many Human Resource functions are now outsourced (contracted out). For example, recruitment, training, payroll, mediation, induction etc.

Reasons for outsourcing HR functions are:

- Management of Human Resources is complex especially with HR law and therefore outsourcing this to a specialist makes common sense. (Access greater expertise)
- It allows firms to concentrate on their prime function
- Helps reduce costs

Another form of outsourcing is using contractors. Contractors may work with other full-time staff. Schools use contractors when they employ substitute teachers. That is:

- It's for a fixed term
- It's at a fixed rate
- No on-costs such as long service leave (LSL), sick pay, holiday pay etc.

Mostly businesses use domestic subcontractors. However, because of global pressures many Aussie businesses are now subcontracting globally. This is mostly to take advantage of cheaper labour. Global outsourcing carries some risks, including:

- Difficulty controlling the quality and reliability of the service
- Cultural differences such as language or accent issues, which may impact on customer service.
- Security issues such as opportunities for sharing of confidential company information and client poaching.

### Exercise 4.1

Indicate whether the following statements is true or false.

True / False Questions	True / False
1. Long service leave, sick pay and holiday pay are known as "on-costs"	
2. HRM refers to the relationship between the employer and customers.	
3. Modern HRM does not accept that legitimate differences exist in work places	
4. Modern HRM sees employees as assets rather than costs	
5. Cultural differences are an advantage of outsourcing	

## 2. Key influences on HR

HR has changed a lot. There are a number of key influences which impact on the Human Resource function. These pose challenges for Human Resource managers.

### A. Stakeholders in the Human Resource process

Stakeholders are any individual or group that has a vested interest in HR process. Their views/demands can influence HR management. Conflict can arise because of competing needs and expectations.

#### 1. Employers

They need workers especially skilled and motivated ones. They also need to manage HR effectively because a better performing workforce means more profits. They are stakeholders in HRM because they use labour to try and meet their business objectives. But because labour is a big cost they also want lower wages (at least tied into productivity) and greater flexibility.

#### 2. Employees

Employees are workers under the control of an employer. They depend on the income they earn by selling their labour. Their aims are often at tension with what employers want because they want higher wages and better working conditions.

Employees today are:

- on average more educated
- demand more challenging and interesting work
- want to be involved in the decision making process
- want more flexible working conditions
- no longer trust one business to look after their needs

Businesses hoping to maintain and motivate skilled staff need to make more of an effort i.e. career plans, training and development, rewards etc

#### 3. Employer Associations

- These were originally created as counterparts to unions.
- Their main role now is to act on behalf of employers i.e. promote interests of employers within the business environment.
- Examples include AIS (Association of Independent Schools), ACCI (Australian Chamber of Commerce and Industry) and AIG (Australian Industry Group).

- They provide advice on such things as awards, unfair dismissals, legislative changes and discrimination issues.
- They negotiate agreements and lobby governments on key policy issues.

#### 4. Trade Unions

They represent the collective interests of employees usually within an industry, trade or occupation. They aim to represent them in efforts to improve wages and the working conditions. The largest Union in Australia is the ACTU: Australian Council of Trade Unions. Qantas has a highly unionised workforce. Their employees are represented by 18 different unions including: Australian Manufacturing Union, Australian Workers Union, Transport Workers Union, Australian Services Union and Australian Aircraft Engineers Association.

#### 5. Government Organisations

The Government is a significant stakeholder in the process. Over time they have significantly affected the industrial relations system as a result of their key roles as:

- i) Legislator – i.e. they pass laws in parliament which provide the legal framework for industrial relations, eg. Superannuation Guarantee Act (by Federal Government)
- ii) Employer – Federal and State Government employee nearly 1/3 of Australian workers, eg. Teachers, nurses, transport workers, post workers, police force.
- iii) Responsible economic manager – Government has some economic goals, i.e. sustained economic growth with low inflation. Government goals often conflict and they can affect industrial relations. Eg. Government wants to improve productivity (micro-economic reform: workplace relations reform) which may conflict with unions and result in job losses.
- iv) Administrator of government policies on industrial relations such as the Fair Work Commission (and industrial tribunals and courts e.g. Federal Court)

The Fair Work Commission (FWC):

- This is a National Government agency which will underpin the Federal Government's Fair Work Act 2009 changes.
- It will: facilitate and approve collective bargaining agreements, adjust minimum wages and deal with unfair dismissal claims and workplace disputes.
- FWC has replaced other existing bodies which include:
  - Fair Work Australia
  - The Australian Fair Pay Commission
  - The Workplace Ombudsman – Now the FAIR WORK OMBUDSMAN under the FWC.

Fair Work Ombudsman:

- The Fair Work Ombudsman is an independent statutory agency created under the Fair Work Act 2009, and is responsible for promoting harmonious, productive and cooperative Australian workplaces.
- The Fair Work Ombudsman educates employers and employees about workplace rights and obligations to ensure compliance with workplace laws.
- Where appropriate, the Fair Work Ombudsman will commence proceedings against employers, employees, and/or their representatives who breach workplace laws.

The Australian Industrial Relations Commission (AIRC):

- This was established under Section 8 of the Workplace Relations Act 1996.
- Now part of the FAIR WORK COMMISSION
- It is an: independent, national tribunal which was established to deal with employment issues such as resolving industrial disputes.
- It seeks to resolve disputes between employers and employees.
- It also hears appeals and handles unfair dismissal cases.

## 6. Society

Society is a stakeholder because it is made up of individuals that are affected by HR outcomes (workers and their families), and more by people with certain values and ethical views.

### B. Social influences

- Social influences impact on Human Resources and need to be managed. These influences include changing work patterns and living standards.
- Changing work patterns.

Many changes in work patterns today appear to be driven by the businesses' needs to reduce costs and improve productivity. Some changes include:

1. A preference of many businesses to have a smaller permanent workforce and to hire casual/ temporary employees as a flexible workforce to meet demand at peak times. As a result, part time and casual employees make up about 27% of the workforce today.
2. Flexible working hours, opportunities for flexible working arrangements including telecommuting (working from home).
3. Mobility of workers and people more likely to make career-changes more often.
4. Decreasing number of blue-collar jobs.

### ■ Population Shifts

The number of women in the workforce has increased. Women now comprise about 44% of the workforce and has a participation rate of about 70%. Employers are recognising the cost savings and benefits of family friendly practices in order to motivate and keep good female staff. Population shifts have also created a more ethnically and diverse workforce. This requires more cultural sensitivity.

### ■ Living Standards

Australians have one of the highest living standards in the world today. These high standards include work health and safety regulations, regular wage increases and superannuation benefits. As living standards rise, workers are likely to push for better working conditions.

## C. Economic Influences

Economic conditions influence how HR is managed.

The demand for labour is determined by the demand for goods and services (economic cycle).

With an economic downturn demand for labour decreases and businesses tend to respond by downsizing (reduce staff numbers by making them redundant). Businesses find it easier to acquire staff and don't need to pay them as much.

With an economic upturn demand for labour increases and businesses tend to respond by recruiting (increasing staff numbers). Businesses find it harder to acquire staff and they have to pay them more.

Globalisation has increased the level of international competition. This is resulted in more of a focus on the bottom line (productivity/profit/survival). Management structures have become flatter, downsizing, more flexible structures (decentralisation). Also staff have to be better trained, wages have increased but only with productivity gains.

### **Case Study COVID-19 has significantly impacted HR**

In Australia's attempt to stem the spread of the deadly respiratory virus, the nation went into lockdown and closed international – and most interstate – borders. Businesses have had to make big changes to their workforce, both in terms of the number of workers and the hours they work. Australia's most trusted brands have been forced to lay off thousands of staff as the coronavirus crisis creates economic devastation. Qantas, Flight Centre, ABC and Woolworths have announced they would let go of thousands of employees as a direct result of COVID-19. Businesses have also had to adjust the way they work, with thousands of workers moving to a working from home environment overnight.

## D. Technological Influences

Technological change is widespread and has a big impact on HR:

- Allows the business to develop more efficient production techniques.
- Affected employee skills as now staff needs to be more skilled (multi-skilled) and educated thereby there is an emphasis on training and development.
- Employee numbers are down in some occupations and up in other jobs.
- Working hours and the nature of existing jobs (more flexible hours, reduces the nature of labour intensive work).
- Creates different work health and safety issues.

## E. Legal Influences

There are a number of laws covering HR (some are complicated and they change regularly). Some of this legislation is State, some is Federal. It means more compliance costs for business. Also, failure to obey these laws exposes the business to big fines, lawsuits by employees and bad publicity. Examples include:

- Employment contracts – they are legally binding agreements between the employer and the employee.
  - a) Under common law the employer has obligations to provide work, pay income and a duty of care (safe working environment). Employees have a duty to obey lawful commands, take reasonable care and carry out duties responsibly.
  - b) Minimum employments standards – The National Employment Standards (NES) are 10 minimum employment entitlements that have to be provided to all employees. They make up the minimum entitlements (safety net) for employees in Australia. They include things like: a maximum weekly hours of work of 38 hours per week, the ability to request flexible work arrangements, up to 12 months unpaid parental leave, annual leave of 4 weeks, 10 days paid carers leave, community service leave, long service leave, leave in regards to public holidays, up to five weeks notice of termination and up to 16 weeks redundancy pay, both based on length of service and the provision of a Fair Work Information Statement.
  - c) Minimum wage rates – employee's base rate of pay for ordinary hours worked, and is generally dependent on the award, enterprise agreement etc. At a national level, the minimum wages are determined by the Fair Work Commission (FWC) – (Minimum Wage Panel), which reviews minimum wages annually, taking submissions from employee unions, employers, and the Government. Minimum wages are set for each industry. Australia's lowest-paid workers will receive \$694.90 per week. The FWC has lifted the minimum wage by 3.3 per cent in 2017 – an increase of 59¢ an hour to \$18.29 an hour.

- d) Awards apply to employees in a particular industry or occupation and set out the minimum terms and conditions of employment for a particular occupation. They are now called 'MODERN AWARDS'. There are 122 industry and occupation awards that cover most people working in Australia as directed by the FWC.
- e) Enterprise Agreements – they are collective agreements between an employer and a group of employees (often represented by their union) made at a particular workplace. Usually for 2 to 3 years and includes terms and conditions of employment. In the national system, enterprise agreements, which alter the award conditions, must pass a 'better off overall test' known as the BOOT, which means that employees must be better off under the enterprise agreement than under the relevant award, or it is not approved as valid by Fair Work Commission. They must be approved by the Fair Work Commission and satisfy the 10 NES. Employers prefer an enterprise agreement system compared with the award system because agreements can be tailored to suit each business.
- f) Other employment contracts

Individual common law contracts, common in the private sector, for those on big money not covered by an agreement, part time, casual etc. These exist when an employer and an individual employee negotiate a contract covering pay and conditions. They are often informal and provide less protection than other agreements to the employee. They don't have to be approved by Fair Work Commission.

Independent Contractors: These contractors are often known as consultants or freelancers, they undertake work for others; however, they do not have the same legal status as an employee. They are most common in the construction industry. The Fair Work Commission has clear criteria to determine a worker as a contractor. A contractor carries most of the risk on a job undertaken, including covering their own superannuation, tax, insurances and leave. This is why many employers prefer to rely on independent contractors as it allows employment risks such as sickness to be shifted to the person undertaking the work.

- Worker's compensation - compulsory insurance covering employees who are injured at work. Laws require that all employers maintain current workers' compensation insurance to insure themselves against compensation claims for workplace injuries.
- Work health and safety – regulates employers to protect the health, safety and welfare of workers (safe working practices). These laws put into effect minimum standards in workplace conditions for the protection of the physical and mental wellbeing of workers and others in the workplace. Employers who ignore WH&S Laws and expose workers to injury or death will face punishments such as fines and licence suspensions, and could face criminal punishments. The NSW government has introduced the Work Health and Safety Act (WHS) 2011 to replace the Occupational Health and Safety (OH&S) Act. This is administered by Safework NSW.

- Anti-Discrimination – The Sex Discrimination Act 1984: makes it unlawful to discriminate (disadvantage) on the basis of race, sex, age, religion, disability etc. This impacts on recruitment, selection, promotion, termination etc. Discrimination cases are heard by Australian Human Rights Commission.
- Equal Employment Opportunity – It is unlawful to discriminate against a person on certain prohibited grounds of discrimination. Employers with 100 or more employees are subject to extra legal requirements in relation to promoting and reporting on their practices that support equal opportunity for women in the workplace. They are required to provide a progress report to the Workplace Gender Equality Agency (WGEA).

### Case Study 7-Eleven

7-Eleven franchise operators have been fined over a \$1 million after an enquiry by the Fair Work Commission found that they have breached federal workplace laws by failing to pay its workers the minimum hourly rate, keep appropriate employment records and issue pay slips.



Some franchises were paying staff hourly rates as low as \$13 an hour. In some cases, franchises paid staff correctly but required employees to withdraw a portion of their wages at a ATM and pay it back in cash. Typically, these staff were student visa-holders from non-English speaking backgrounds.

As well as the heavy fines 7-Eleven have been ordered to make major changes to its payroll system including installing biometric shift scanning systems and CCTV at all stores to allow head office to monitor work hours to make sure employees are paid correctly.

## F. Ethics and Corporate Social Responsibility

There are lots of HR issues in the workplace which are influenced by ethical and social considerations. There is pressure on HR to perform its function in a way that is morally right and beneficial to society.

Ethical and social responsible employers

- Comply with legislation
- Provide a safe work environment, safe practices
- Create challenging and interesting work
- Implement change with collaboration
- Offer flexible work hours

- Offer pleasant working environment
- Promote good working relationships with staff
- Foster training

Benefits include a more motivated and productive staff, lower absenteeism and staff turnover, ease in recruitment etc.

### Case Study Banking Royal Commission

The banking royal commission was established in December 2017 after lots of public pressure. Its mandate was to investigate whether Banks have engaged in misconduct and whether mechanisms are in place to compensate victims.

The Commission found Australian banks were engaged in misconduct. Areas investigated included: bribery, forged documents, failure to verify customer living expenses before lending them money and selling insurance to people who can't afford it.

### Exercise 4.2

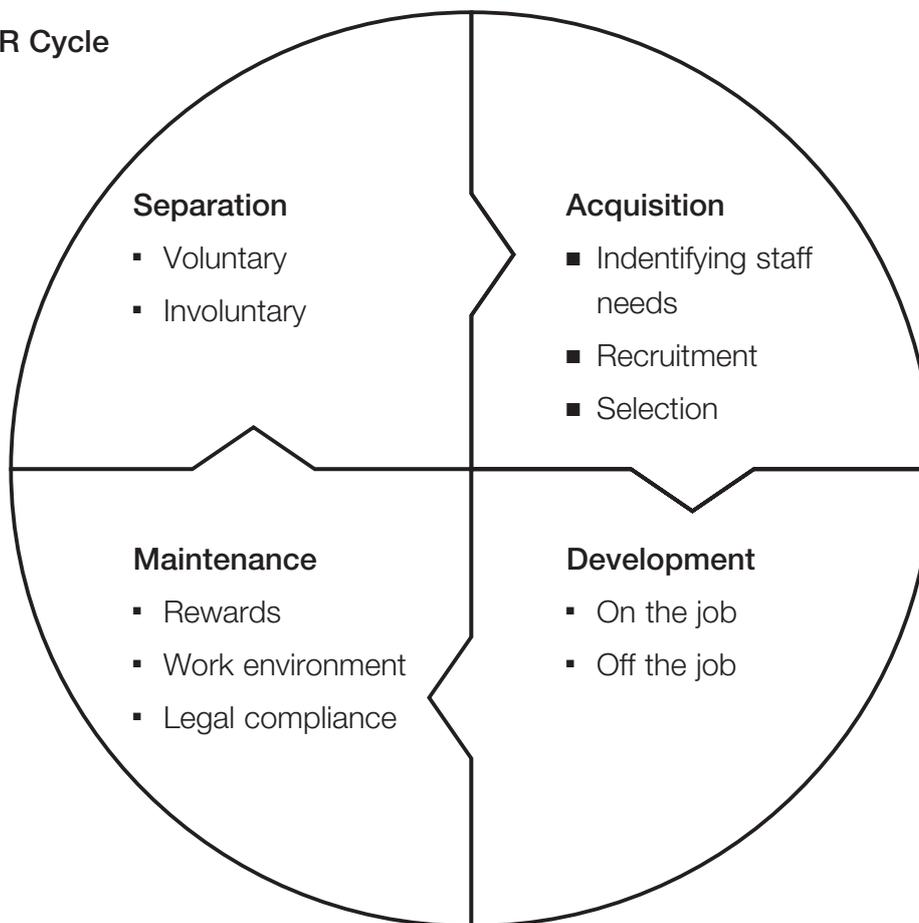
Indicate whether the following statements is true or false.

True / False Questions	True / False
1. Economic conditions have little impact on how staff are managed.	
2. Population shifts have created a more ethnically and diverse workforce.	
3. An agreement sets out minimum wages and working conditions.	
4. The views and demands of stakeholder's influence HRM.	
5. Employers are not legally required to take out worker's compensation.	

### 3. Process of HRM

HRM is an ongoing process. It involves 4 main processes or stages known as the Human Resource cycle.

Figure 27 HR Cycle



Human Resource managers must follow systematic processes to ensure that HR is carried out efficiently, effectively, consistently, fairly and with the appropriate degree of transparency.

#### A. Acquisition

Businesses need staff that have the right skills and attitudes. Acquisition means to get, obtain staff.

Acquisition involves 3 steps.

##### a) Identifying staff needs (also called HR planning)

This means making sure the business has the right number of qualified staff (ensures a proper match). This involves

- Identifying the demand for employees at a point in time (What will be needed?)

- Forecasting the supply of employees at a point in time (HR resources likely to be available)
- Determining variances – action plan to remedy the anticipated shortfall or surplus i.e. shortage (recruit), surplus (downsize and redundancies).

Once a decision has been made to recruit, a job analysis, job description and job specification are produced.

- JA – process of collecting, analysing information about individual jobs.
- JD – statement providing basic information about the job, title, purpose, reporting relationship, activities/tasks etc
- JS – statement of personal attributes eg qualifications, experience, ability to deal with people etc

#### b) Recruitment

Recruitment is providing a pool of potentially suitable applicants (casting the net). From which the best can be selected.

Effective recruitment helps increase the success rate of the selection process.

It needs to be fair and legally compliant with anti-discrimination legislation, equal employment opportunity (EEO) etc.

Sources of recruitment are internal and external. (Refer later in the chapter)

Techniques include

- Advertising (newspaper and especially now the internet, sites like Seek)
- Head hunters
- Recruitment agencies
- Word of mouth

Recruitment is costly in terms of time and money.

#### c) Selection

This means choosing the best candidate.

It also needs to be fair and legally compliant with anti-discrimination legislation, EEO etc.

Selection techniques include:

- Application forms, covering letters, CV's
- Interviews

- Psychological tests (intelligence, aptitude and personality)
- References

Selection is also costly in terms of time and money.

### B. Training and Development

Training is preparing staff for their current job.

Development is preparing staff for future jobs. It is also known as succession planning.

Developing/enhancing skills is achieved via:

- Professional learning (e.g. courses, education)
- Mentoring/coaching
- Performance appraisal that develops a long-term career

### Benefits of Training and Development

**Figure 28 Benefits of Training and Development**

<p><b>For Employee</b></p> <ul style="list-style-type: none"> <li>▪ enhanced skills</li> <li>▪ more marketable</li> <li>▪ better job satisfaction</li> </ul>	<p><b>For Business</b></p> <ul style="list-style-type: none"> <li>▪ more efficient</li> <li>▪ more productive</li> </ul>
<p><b>For Economy</b></p> <ul style="list-style-type: none"> <li>▪ more competitive</li> <li>▪ more productive</li> </ul>	<p><b>For Customer</b></p> <ul style="list-style-type: none"> <li>▪ gets a better service/product</li> </ul>

### Induction (orientation)

This is when someone first joins the business.

Induction introduces new employees to their job, co-workers, the business and its culture.

There are 2 types of induction:

- Job Induction. This is what you are doing at work
- Organisational induction. This tells you the business's values, its policies etc.

Many employees leave the business after a short period of time, it may be because the induction process was poor. A well prepared or good induction program gives:

1. Employees a positive attitude to the job and business.
2. It builds a new employees confidence in the job
3. It helps establish business good relationships with co-workers and supervisors
4. It stresses major safety policies

#### b) Training Programs

An effective training program is planned and is seen as integral to the business strategy and to maintaining or developing a business' sustainable competitive advantage. Ongoing training is critical due to rapid technological change.

Training can be on the job or off the job. On the job techniques are methods applied in the workplace while the employee is working eg. apprenticeships, demonstration, mentoring, job rotation. Off the job techniques are away from the workplace eg. higher education, outside courses, conferences etc.

**Figure 29 Advantages and Disadvantages of Training Programs**

	<b>Advantages</b>	<b>Disadvantages</b>
On the job training	<p>Generally the most cost effective</p> <p>Employees are productive</p> <p>Opportunity of learning whilst doing</p> <p>Training alongside real colleagues</p>	<p>Quality depends on the ability of the trainer and time available</p> <p>Bad habits may be passed on</p> <p>Learning environment may not be conducive</p> <p>Potential disruption of operations</p>
Off the job training	<p>A wider range of skills or qualifications can be obtained</p> <p>Can learn from outside specialists and experts</p> <p>Employees can be more confident when starting a job</p>	<p>More expensive</p> <p>Lost working time and potential output from employee</p> <p>Employees now have new skills and qualifications and may leave for better jobs</p>

## C. Maintenance

Maintenance is about retaining staff and managing their wellbeing at work. It's also about motivating staff to be more productive.

It includes things like:

- Remuneration (pay) – Monetary and Non- Monetary benefits, based on job descriptions, pay structures and performance appraisal. Remunerations is used to recruit and motivate staff and reward performance. Also a big cost to the business so you need to get the balance right.
- Work environment – staff amenities/facilities
- Legal compliance – Work Health and Safety, Workers Compensation, Anti-Discrimination, EEO etc.
- Managing employee-employer differences (Grievance procedures)
- Worker participation/communication – involving employees in the management process e.g. regular team meetings, staff bulletins, newsletters, social functions etc. Strategies that focus on worker participation and communication build trust, build a positive workplace culture and help prevent conflict.
- Flexible working conditions – patterns of work that allow employees to balance work and family responsibilities more effectively. These include flexible working hours like job sharing, part time work and family-friendly programs like Childcare – paternal leave, workplace childcare centres, Family support – special leave provisions and Family leave – child and parent.

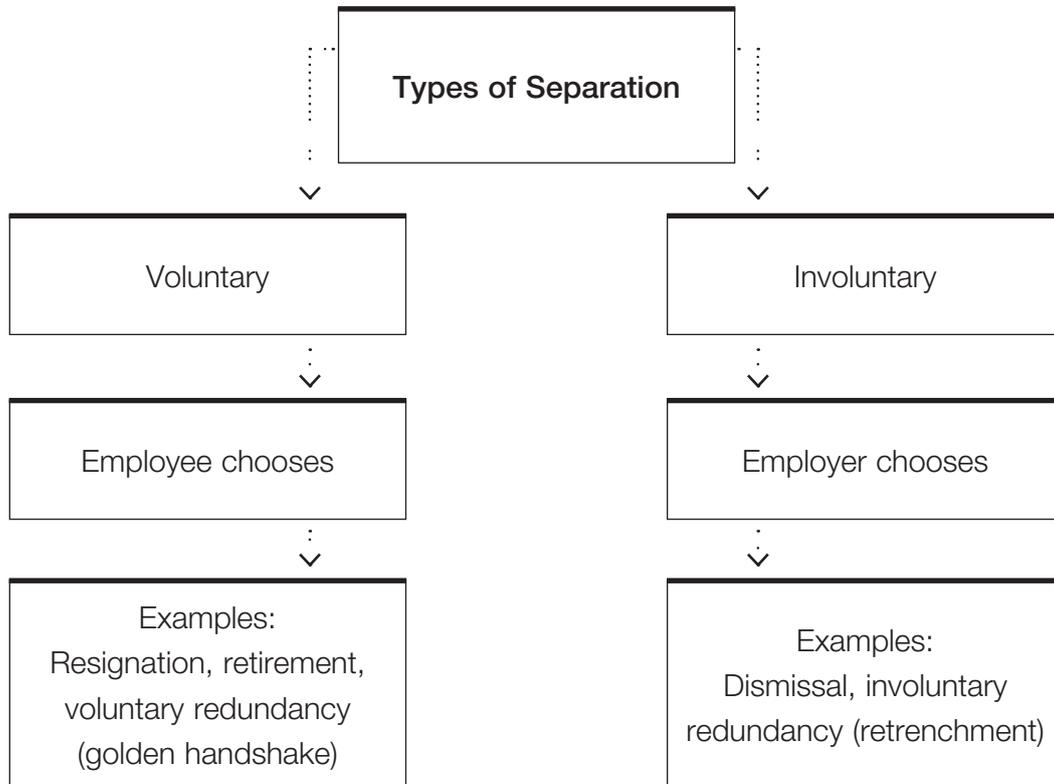
Poor maintenance will lead to unmotivated staff. Problems associated with unmotivated workers include:

- Unmotivated employees are likely to work inaccurately and inefficiently.
- There could be an increase in absenteeism which could disrupt projects and increase costs
- Unmotivated employees can affect the morale of other workers.

## D. Separation

This is managing employees leaving the organisation. It's the ending.

**Figure 30 Types of Separation**



### Case Study National Australia Bank



NAB has just announced plans to downsize its workforce by 12% to cut operating costs as more processes have become automated. The Bank plans to shed 6000 roles while adding 2000 technology jobs over the next 3 years including hiring specialists in software engineering data and security. Hiring more tech professionals comes with own set challenges because they are highly sought after.

#### Unfair Dismissal:

- This is when an employee is dismissed by their employer and they believe the action is harsh, unreasonable or unjust.
- Fair Work Commission provides the grounds for unfair dismissal and deals with cases of unfair dismissal.

### Exercise 4.3

Indicate whether the following statements is true or false.

True / False Questions	True / False
1. Voluntary separation is when the employer decides.	
2. The main purpose of recruitment is to attract a sufficient number of applicants.	
3. Ongoing training should be part of every workplace	
4. Off the job training is generally the most cost effective.	
5. Separation is the ending of the employment contract.	

## 4. Strategies in HRM

Businesses are increasingly recognising the value of effective HR. Therefore, they are seeking strategies to better manage their staff. Examples of these strategies include:

### A. Leadership style

Leaders play a big role in HR. They are constantly interacting with their staff. It is crucial for a leader to provide direction, implement plans and motivate staff in a manner that enhances workplace performance.

Leadership styles are different approaches by those in leadership positions. That is ways that they communicate with staff. Today workers prefer a less authoritarian approach. They prefer to be consulted, empowered etc.

### Figure 31 Leadership Styles

< . . . . . >

#### Autocratic Leadership Style

- Authoritarian
- Management maker decisions with little or no input from staff
- Low levels of staff engagement

#### Democratic Leadership Style

- Consultative
- Workers have input into decision making
- High levels of staff engagement

Two other leadership styles include:

- **Bureaucratic:** Here management decisions are based on policy guidelines or manuals, employees can ask questions to clarify but no suggestions called for. This style works best where jobs are dangerous and strict procedures should be followed, i.e. risky tasks are carried out. The problems with this style are that it usually results in de-motivated staff.
- **Laissez-faire:** Here the leader outlines goals and basic parameters of what is allowed/expected, then responsibility lies with individuals/workgroups. This style works best with staff that are experienced.

## B. Job Design

Businesses need to be organised. The more organised and efficient the business is the better it functions. On the other hand, to recruit and retain good staff businesses need to offer interesting and rewarding roles.

A well designed job helps this. Job design is the process of designing the content of a job. It is a product of a job analysis. This is where all the tasks, responsibilities, personal attributes and reporting relationships are detailed in a position.

Job design strategies include:

- **Job rotation-** employees move from one job to another. Pluses – variety, challenge, multiskilling
- **Job enlargement –** employees are given additional tasks. Pluses – increase motivation, provide a pathway to promotion
- **Job enrichment –** employees are given more challenging tasks. Pluses – increased responsibility, autonomy means greater employees satisfaction, higher retention rates etc.

There is a choice between giving workers more general or specific tasks. Repetitive tasks can result in demotivated staff and increases the chance of mistakes. General or specific tasks is a choice a HRM makes depending on staff skill and the nature of the job. Specific tasks are narrow and repetitive. General tasks are broad with variety.

## C. Recruitment

Recruitment was covered as part of acquisition. Effective recruitment allows the most appropriate employee to be selected.

This can be one of the most time-consuming and expensive HR functions. It is also crucial; hiring the wrong person can lead to economic (e.g. increased training costs), workplace (e.g. job dissatisfaction), and legal problems (e.g. accidents or discrimination). Firms must decide

whether to perform this HR function internally (that is, by itself), or externally (by hiring a specialist firm like an employment/recruitment agency or head hunting company).

Recruitment methods include: internal and external.

**Figure 32 Recruitment Methods**

	<b>Internal Recruitment</b>	<b>External Recruitment</b>
<b>Examples</b>	Promotions, transfers	Advertisements (particularly online), contractors, head hunters, competitors
<b>Benefits</b>	<p>Familiarity with employees aids in accurate job placement</p> <p>Provides motivation of employees to perform well and develop skills</p> <p>Lowers overall training and induction costs</p> <p>Vacancies can be filled more quickly at a lower cost</p>	<p>Tends to increase selection accuracy</p> <p>Prevents the ripple effect that arises from hiring from within</p> <p>Tends to bring in new ideas and innovations</p>
<b>Limitations</b>	<p>Employees may not be prepared or qualified for the vacancy</p> <p>May cause a ripple effect as one vacancy filled from within causes another vacancy</p> <p>May lower the influx of new ideas and innovation</p>	<p>Increases the recruitment and selection costs</p> <p>Increases training and induction costs</p> <p>Takes longer to fill vacancies</p> <p>May lower employee motivation and morale</p>

Businesses need to attract staff with:

- General Skills – flexibility, ability to work as a team or independently, ability to work under pressure, willingness to learn, positive attitude
- Specific skills – expertise to do a particular task (job specific)

People with general skills can have a job customised to their talents and are often a good cultural fit to a workplace. These skills however are not necessarily important to doing a task. Some complex jobs require specific skills as without them quality can diminish or tasks may not be done at all. People with specific skills may not be adaptable and even harder to find or require higher wages. Therefore a firm would tend to have a mix of generalists and specialists. Importantly, both people with general or specific skills require on-going training as job tasks evolve.

### D. Training and Development (T&D): Current or future skills

T&D was covered as an important stage of the Human Resource cycle. Training aims to develop skills and attitudes to improve work performance. (Current skills)

Development is more focused on enhancing employee skills in line with the future needs of the business. (Future skills)

**Figure 33 Current v Future Skills**

	<b>Current skills</b>	<b>Future skills</b>
<b>Definition</b>	Employees taught skills to do their job better	Employees taught skills that can be used in the future
<b>Examples</b>	Teaching employees to use new technology, software, process	Developing management skills, training staff to do tasks performed by others
<b>Advantages</b>	Allows employees to keep up with new technology, can motivate staff because they feel they can do their job better, leads to a higher standard of work (productivity)	Great for succession planning, can be a very effective motivational tool, reduce staff turnover
<b>Disadvantages</b>	If they are learning the same things this may not be a good motivator (may get bored), once a certain level of competence is achieved further improvements may be minor	Employees may leave the business before applying their new skills, future is unpredictable

**Training: Current Skills:** Training for current skills is designed to enable the worker to do their current job better. This may mean teaching them how to use new technology so that they can work more efficiently, or training them in new quality management processes to reduce defects in their work. The business will see the benefits immediately – as soon as the skills are learnt and implemented.

**Training: Future Skills:** This sort of skills training is a good way for the business to prepare for the future. If employees have a wide variety of skills, they may be able to cover for the absences of their colleagues or could be promoted into higher positions. It can be an effective motivation tool, as employees feel that they are developing as individuals, learning skills that make them more marketable.

## E. Performance management – developmental or administrative

Performance Management is a systematic process of evaluating and managing employee performance.

Performance Management (PM)

- Provides a basis for pay and promotion
- Assesses the training and development needs of employees
- Clarifies strategic goals and performance objectives
- Provides individual feedback to aid improvement

The developmental approach is much more than the administrative approach. It focusses on using PM to improve performance. Rather than judging the outcome, the role of the manager is more of a counsellor. It appraises employees as individuals. It uses PM as a method of increasing motivation and development. It provides a foundation for continuous improvement between the employee and management. And as such it's seen as a more continuous process. Here the business embraces the concept of performance management. It goes beyond formal legal requirements in an effort to improve business practices. This approach is expensive to implement as it requires significant financial and human resources. Businesses who implement this approach are more likely to improve productivity in the long-term.

The administrative (traditional) approach uses PM for pay increases, promotions and terminations.

It's more of an annual review of past performance. The benefits include:

- It doesn't take up a lot of resources, such as time and labour
- It encourages promotions and pay increases based on the employee's performance

The costs include:

- 'Tick and flick' styled reviews may not be done seriously and uncover any real meaning to review performance

There may be no follow-up action taken.

## F. Rewards – monetary and non-monetary, individual or group, performance pay

A combination of rewards is used in the workplace. An effective rewards management system should attract, retain and motivate employees. Reward systems are increasingly linked to performance management through enterprise bargaining and individual contracts.

- **Monetary rewards**  
These financial rewards are the additional monetary payments given to employees beyond their minimum legal entitlements. These have direct costs associated.
- **Non-Monetary rewards**  
These are benefits associated with the job itself and are usually categorised as fringe benefits, status-related or intrinsic rewards. These may be less tangible but also very effective.

**Figure 34 Examples of Monetary and Non-Monetary Rewards**

Monetary (Financial) Rewards	Non-monetary Rewards
Bonus, commission, profit share, employee share schemes	Flexible working conditions, recognition, career opportunities, interesting work

### Case Study GOOGLE

Google is one of the top technology companies in the world. As well as providing great monetary benefits to its employees the tech giant has an amazing array of non-monetary benefits that attracts and keeps great staff like even bringing pets to work. These include:

- Free healthy and varied breakfasts, lunch and even dinner if they work late
- Free coffee and juice from bars scattered throughout their workplace
- Free ride to and from work on a designated bus with Wi-Fi
- In house tech support 24/7
- 6 weeks maternity leave for not just mums but dads as well plus a baby bonus to help with child expenses
- Free onsite day-care for children
- Free fitness classes and gyms
- Working with smart, driven and engaged colleagues
- Career growth and development
- Foster creativity (80/20 rule allows employees to dedicate 80% of their time to their primary job and 20% working on a passion project that they believe will benefit the company)
- Massage credits given for jobs well done on projects
- In addition to holiday leave employees can take 3 months unpaid time off to peruse interests like work for a NGO

Strategies for rewarding workers with monetary benefits:

1. Individual or Group

Individual rewards pay each worker in the team a different amount based on their role, characteristics, effort, performance etc. Whilst some rewards are individual many businesses today place employees in work teams, sharing similar goals and job descriptions. Group rewards pay each team member on the basis of the group.

2. Performance Pay

This refers to the process of linking part of an employee's income to their performance at work. It is often related to executive remuneration. Types include: bonuses, commission, level of responsibility/base pay increase. For example at Qantas, the CEO, Alan Joyce got a 490 per cent pay rise, pocketing a \$9.8 million bonus after Qantas profits turned around.

### G. Global – costs, skills, supply

Globalisation has given businesses access to vast pools of workers (can access the global market for labour). It's a relatively new strategy of HRM, certainly now a more common one. There has been a big growth in the global outsourcing especially in routine and repetitive tasks. It's also made managing HR more difficult (tricky) given the differences in language, culture, training institutions, legal issues etc.

**Figure 35 Global Advantages and Disadvantages**

Global advantages in terms of costs, skills and supply	Global disadvantages in terms of costs, skills and supply
<ul style="list-style-type: none"> <li>▪ Labour rates are much lower especially in Asia</li> <li>▪ Increases the labour supply from which HR managers can recruit workers (Aust in particular faces skills shortages)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Harder to control the quality and product requirements (may see a fall in quality)</li> <li>▪ Cost of training labour in new skills</li> <li>▪ Can produce bad publicity for the business</li> <li>▪ Differences in language, culture etc makes management difficult</li> </ul>

A global business usually uses one of the following staffing models:

- **Ethnocentric** – employing staff from the parent company (expat) to key management positions.  
Advantages: They already know about the business and its culture, possibly more qualified and skilled.
- **Polycentric** – employing a local (from the host country) to a key management position.  
Advantages: They already understand local laws, cultures, language etc, avoids expenses with expatriate managers (relocation costs)

- **Geocentric** – employing the best, most suitable candidate irrespective of country/nationality.

## H. Workplace disputes (WD)

Conflict between HR stakeholders is inevitable – they have conflicting interests. Workplace Disputes can be damaging. A Workplace Dispute is a withdrawal from work or a refusal to permit some or all members to work.

Disputes usually arise during enterprise bargaining over:

- Remuneration – wages, allowances, entitlements
- Employment conditions – working hours, leave, benefits, health and safety
- Job security/management issues – restructuring, downsizing, outsourcing, suspensions or discrimination

WD include things like strikes, pickets, work to rule, lockouts, bans.

Businesses seek to minimise workplace disputes. Many firms try and develop a corporate culture in which disputes are minimised through cooperative working relationships and by training staff in procedures, policies and guidelines for managing disputes. Effective HR requires prompt and equitable settlement of disputes. A grievance is a dispute between stakeholders, usually the employer and the employee. Businesses workplace dispute resolution strategy is called a grievance procedure. This outlines the process for resolving the grievances in the workplace. It includes the rules and procedures that employees, unions and employers must follow in order to resolve a dispute. Developing this policy for use in the employment relationship has many benefits including:

- Provides a clear outline of issues that are regarded as grievances
- Illustrates the correct processes to use
- Provides a mechanism for a quick resolution

The process of resolving a dispute can be complex and it depends on the willingness of stakeholders to cooperatively work together to reach a settlement satisfactory to all parties.

### *Steps in the Process of Dispute Resolution*

#### 1. Negotiation

This involves a discussion between both parties in an attempt to resolve the dispute. The attitude of management in acknowledging the nature of the dispute and being prepared to listen to the concerns of employees is crucial. Collective bargaining is often used to describe negotiations over workplace disputes.

## 2. Mediation

This occurs when an independent third party with no ties to either stakeholder may be requested to assist the conflicting stakeholders to reach a settlement. The mediator could be: someone from Human Rights and Equal Opportunity Commission (HREOC) or retired judge or barrister. The mediator cannot impose their decision or judgement – their decision is NOT binding.

## 3. Grievance procedures

This is the initial way of dealing with any industrial dispute within the workplace. Here employees have the opportunity to have their complaints and concerns heard and dealt with. Managers are trained in procedures, policies and guidelines for managing disputes before they escalate into industrial action. Grievance procedures have been formalised so that there is a step by step process to follow to resolve a dispute. Sometimes disputes may be referred to a special grievance committee at the business.

## 4. Involvement of courts and tribunals

## ■ Conciliation

If the parties cannot reach a settlement through negotiation or mediation, then the Fair Work Commission (FWC) is notified. Their role is to assist the stakeholders to reach an agreement. Conciliation occurs when a conciliator is appointed from FWC, both parties must attend the meeting, but the conditions of the agreement are not legally binding.

## ■ Arbitration

This is the final stage when lawyers from both sides present their case to Fair Work Commission (The Australian Industrial Relations Commission) who reaches a final decision which is legally binding on both parties.

**Exercise 4.4****Matching**

Match the following statements with the correct terms below.

1. When a position is filled by existing employees.	
2. Process of assessing employee behaviour.	
3. The way that a set of tasks, or an entire job is organised.	
4. The steps followed to resolve a workplace difference.	
5. Discussions between parties to solve an industrial dispute.	

**Word Bank:** Grievance procedure, Negotiation, Performance management, Internal recruitment, Job design

## 5. Effectiveness of Human Resource Management

Human Resource strategies are expensive. To ensure the effectiveness of HR strategies, evaluation is essential. The impact on the bottom line (valued in terms of profits/costs) must be justified if the Human Resource function is to be effective.

There are several indicators used to measure the effectiveness of Human Resources.

### A. Benchmarking Key Variables

Benchmarking is used to compare a business's performance against other businesses or against 'best practice' in the industry. The aim is then to encourage changes to result in improvements.

### B. Changes in staff turnover

Staff turnover refers to the rate at which staff are separated from the business. That is, how frequently employees leave, and new employees must be hired to replace them. Essentially, it looks at how long employees tend to stay at the business. If turnover has increased, it indicates that HRM has been ineffective. It may suggest that workers feel unmotivated, insufficiently rewarded or unvalued at the company.

### C. Absenteeism

This refers to staff choosing to stay away from work (as opposed to unavoidable absences due to illness or a family death). This can be very difficult to measure because employers can't always tell whether employees are being honest about their absence from work. Some of the costs associated with absenteeism include: The business may be paying the employee for their legitimate days off when they may not be sick. A temporary worker will need to be employed to cover the absence.

### D. Accidents

If accident levels are high, it indicates that HRM needs to become more effective. It also indicates that the workplace may not be providing a safe working environment. Some of Australia's common workplace accidents according to Safe Work Australia include: Fatigue, trips and falls, stress and mental health, falling from heights and falling objects.

### E. Level of disputation

This indicates how many disputes or types of industrial action are taking place. These could include: strikes, go slows, work to rule by employees or lockouts by employers. These disputes are very disruptive, create tension and can badly damage the business's reputation. High levels of disputation indicate ineffectiveness, suggesting that employees may feel insufficiently rewarded or have poor working conditions. It also indicates tension or a breakdown of the relationship between the employer and employees.

### F. Worker satisfaction

Worker satisfaction could include issues such as: how interesting and rewarding employees' tasks are, standard of pay, working hours, and the physical workplace conditions. If workers are unsatisfied they could become unmotivated and may separate from the business.

Worker satisfaction levels can be regularly assessed by surveying workers and through regular meetings with workers. One of the keys to boosting productivity is to ensure workers are committed and motivated.

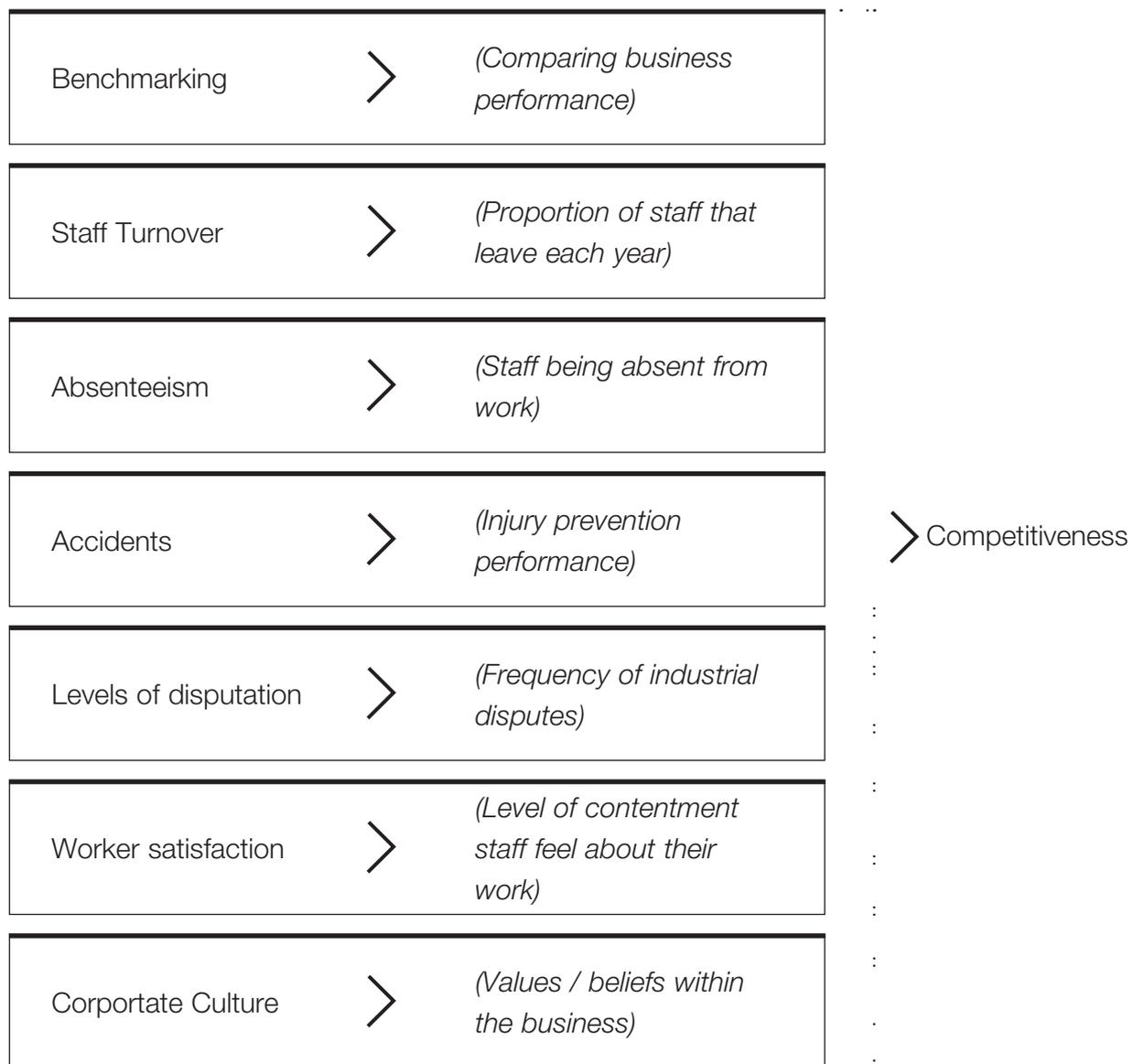
### G. Corporate Culture

The indicators that reveal a workplace has a poor corporate culture include:

- High levels of staff turnover
- Poor customer service
- High levels of absenteeism
- A large number of accidents
- High levels of disputes and internal conflict.

These problems are reflected in poor business performance, lower sales and lower profits.

**Figure 35 Effectiveness of HRM**



**Exercise 4.5****Multiple Choice Question**

Select the alternative A, B, C or D which best answers the question.

1. Which would cause high staff turnover?
  - a) Democratic management style
  - b) Flexible working conditions
  - c) Job rotation
  - d) Autocratic management style
  
2. Which of the following best outlines the strategic role of human resource management?
  - a) Maintenance of employee information records and payroll
  - b) Delivery of line management human resources in all businesses and work places
  - c) Management of the employer/employee relationship to achieve business goals
  - d) Management aimed at increasing competitiveness.
  
3. Which of the following are characteristics of independent contractors?
  - a) They are typically self-employed and are entitled to the same benefits as full time employees
  - b) They are entitled to the same benefits as full time employees and work for a fee within a set timeframe
  - c) They work for a fee within a set timeframe and arrange their own insurance and superannuation
  - d) They arrange their own insurance and superannuation and their employment is typically ongoing and continuous.
  
4. A sporting goods company prepares a job description for a new role. This is an activity within which human resource process?
  - a) Acquisition
  - b) Selection
  - c) Identify staff needs
  - d) Maintenance

5. Which of the following is an example of involuntary separation?
- a) Resignation
  - b) Retirement
  - c) Redundancy
  - d) Referral
6. What is the process concerned with keeping valuable staff?
- a) Acquisition
  - b) Development
  - c) Maintenance
  - d) Separation
7. What does induction involve?
- a) Examination used to recruit staff
  - b) Introduction to the practices of the business
  - c) Performance appraisal of staff
  - d) Job rotation
8. Which of the following is an example of non-monetary rewards?
- a) Independence and flexible hours
  - b) Profit sharing and redundancies
  - c) Employee share scheme and performance pay
  - d) Increased wages and an upgraded company car
9. Which of the following provisions is included in the National Employment Standards?
- a) Up to five weeks notification by either employee or employer of separation
  - b) Paid leave to work for natural disaster relief organisations like the SES
  - c) A maximum of 38 hours for full-time employees plus reasonable additional hours
  - d) Six weeks paid annual leave each year (pro rata)

10. Which of the following Act of parliament is the most current Act which governs occupational health and safety in the workplace?
- a) Occupational Health and Safety Act
  - b) Work Cover Act
  - c) Workers Compensation Act
  - d) Work Health and Safety Act
11. Mason Stein has been recruited as a senior accountant for an accounting firm. He has negotiated a salary of \$150 000 plus superannuation and a company car. Which of the following employment contracts is likely to be used by Mason?
- a) Modern Awards
  - b) Enterprise agreements
  - c) Common Law contract
  - d) Mediation agreements
12. Who administers work health and safety laws and worker's compensation in NSW?
- a) Fair Work Commission
  - b) Safework NSW
  - c) Work Cover NSW
  - d) Fair trading NSW
13. Increased demand for gold due to global financial insecurity causes a gold-mining company to increase the number of people employed in their mines. What type of influence on human resources was this?
- a) Financial
  - b) Social
  - c) Economic
  - d) Legal

14. Kevin works as a teacher at an independent school in NSW. The School has its own salary agreement with its staff. What is the name of the employment contract the school uses to employ its staff?
- a) Modern Award
  - b) Enterprise Agreement
  - c) Australian Workplace Agreement
  - d) Common Law Contract
15. Which of the following correctly lists the four processes of human resource management?
- a) Recruitment, Acquisition, Development and Maintenance
  - b) Acquisition, Development, Separation and Training
  - c) Acquisition, Development, Maintenance and Separation
  - d) Recruitment, Maintenance, Separation and Performance Management

#### Exercise 4.6

SA Airways is a global airline company that is facing increasing competition. Management have decided to downsize the workforce by 30% through making certain positions redundant and offering new financial incentives for remaining staff to increase their productivity.

- a) Identify the TWO human resource processes that will be used in this situation. 2

1) \_\_\_\_\_

2) \_\_\_\_\_

- b) Explain how changes in technology might influence human resource management at the airline. 2

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**Exercise 4.8**

Kulula International is a leading global hotel company that is facing increasing competition. Management have decided to downsize the workforce by 25% by making certain positions redundant and aim to train and develop the remaining staff.

a) Identify the TWO human resource processes that will be used in this situation. 2

1) \_\_\_\_\_

2) \_\_\_\_\_

b) Outline TWO legal factors which could influence Human Resource management at Kulula International. 4

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c) Describe ONE advantage of a well trained workforce for Kulula International. 2

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## Answers to Exercises

### Exercise 4.1

1. True 2. False 3. False 4. True 5. False

### Exercise 4.2

1. False 2. True 3. False 4. True 5. False

### Exercise 4.3

1. True 2. False 3. True 4. False 5. True

### Exercise 4.4

1. Internal recruitment 2. Performance management 3. Job Design  
4. Grievance procedure 5. Negotiation

### Exercise 4.5

1. D, 2. C, 3. C, 4. A, 5. C, 6. C, 7. B, 8. A, 9. C, 10. D, 11. C, 12. B, 13. C, 14. B, 15. C

### Exercise 4.6

(a) Sample Answer: Maintenance and separation

(b) Sample Answer: Improved technology and its introduction to the airline's operations will mean that some staff may need to be retrenched and their positions made redundant. Therefore, management would need to handle this situation delicately as staff will be feeling anxious about the possibility of them being made redundant. Remaining staff will also be affected as the new technology will require additional training and development. Staff may resist this change as it will require them to master a new set of skills.

(c) Answers could include: employers, employees, employer associations, unions, government and society

Sample Answer: Employers and employees at SA Airways would both be involved in the negotiation of the incentives being offered to improve employee productivity. Employers may include their employer association who would influence the human resource process by helping to negotiate a suitable set of incentives which are legally accepted by the Fair Work Commission and are cost effective for SA Airways. Employer associations would also guide SA Airways as to the legal steps required to make some of their employees redundant. Employees at SA Airways may include the unions in this process to help them negotiate a suitable set of incentives that would be in their best interest. Unions would also help the employees deal with their rights in regard to the redundancy process.

**Exercise 4.7**

- a) Answers could include: Employers, employees, unions, employer associations, government organisations, society
- b) Answers could include: Maximum weekly hours of work, requests for flexible work arrangements, parental leave and related entitlements, annual leave, personal/carer's leave and compassionate leave, community service leave, long service leave, public holidays, notice of termination of employment, provision of fair work information sheet

Sample Answer: The human resource department should be aware of the maximum weekly hours of work which is 38 hours a week plus reasonable additional hours as well as annual leave entitlements which are generally four weeks paid leave per year.

- c) Answers could include: ACTU, Independent education union, transport workers union etc.

Sample Answer: Unions act on behalf of employees in collective bargaining sessions and before industrial tribunals and courts. They provide advice on matters such as unfair dismissals and discrimination issues, make submissions to safety net wage claims, negotiate agreements and lobby governments with the views of employees.

- d) Answers could include: Outsourcing – Global Outsourcing

Advantages – Cost savings, economies of scale, regulatory differences, access new ideas, allows bus to focus on core activity,

Disadvantages – ethical considerations/reputation image, loss of quality, communication issues, logistics complexity, loss of skills, cultural differences

Sample Answer: Global outsourcing involves the use of third party specialist businesses to perform functions for the business without the constraint of national boundaries. One advantage of global outsourcing is potential cost savings as inputs such as labour may be cheaper in other countries. This allows a business to reduce its production costs leading to competitive advantage/ cost leadership and greater profits. One disadvantage of global outsourcing may be more complex logistics. As the business now has functions being performed globally by outside business the co-ordination and integration becomes more complex. This can result in inefficiencies and quality reduction which would negatively impact on sales.

**Exercise 4.8**

- a) Answers could include: Development and Separation
- b) Answers could include: The employment contract, minimum employment standards, minimum wage rates, awards, enterprise agreements, common law contracts.

Sample Answer: Modern awards provide the minimum legal standards and conditions in a particular occupation or industry. An award covers such employment conditions as pay rates, penalty rates, hours of work, superannuation and other relevant conditions.

Common law contracts are legally enforceable contracts for higher paid (> \$118k) employees. The terms and conditions are not able to go below the relevant award for the industry.

Both will influence the HR management of a business as they represent minimum costs to the business.

- c) Answers could include: Increased efficiency and productivity

Sample Answer: A well trained workforce at Kulula International will perform their required tasks to a high standard, thereby increasing efficiency and productivity in the business. This may, in turn result in lower costs, greater customer satisfaction, improved relationship marketing and return business, and increased profitability. Training staff does have an initial and ongoing going financial cost, but relevant and focused training will allow these costs to be outweighed by the benefits to customers and the business.

- d) Answers could include: Monetary and non-monetary benefits. Improved communication in the workplace, employee participation in decision making, flexible work arrangements might lead to improved morale amongst staff.

Sample Answer: Human resource maintenance focusses on the management of staff retention and staff well-being. It therefore involves the provision of monetary and non-monetary benefits to employees, such as wages and salaries and superannuation, and fringe benefits such as private car usage and gymnasium membership and also managing workplace health and safety issues. It might also include the payment of incentive payments for employees based on performance such as sales. Employee participation in decision making and improved communication between various levels of management and employees allows improved business processes by creating a sense of dual commitment from employer to employee and from employee to employer. Each of these human resource maintenance processes might assist in developing the business' efficiency and lead to greater profitability.

