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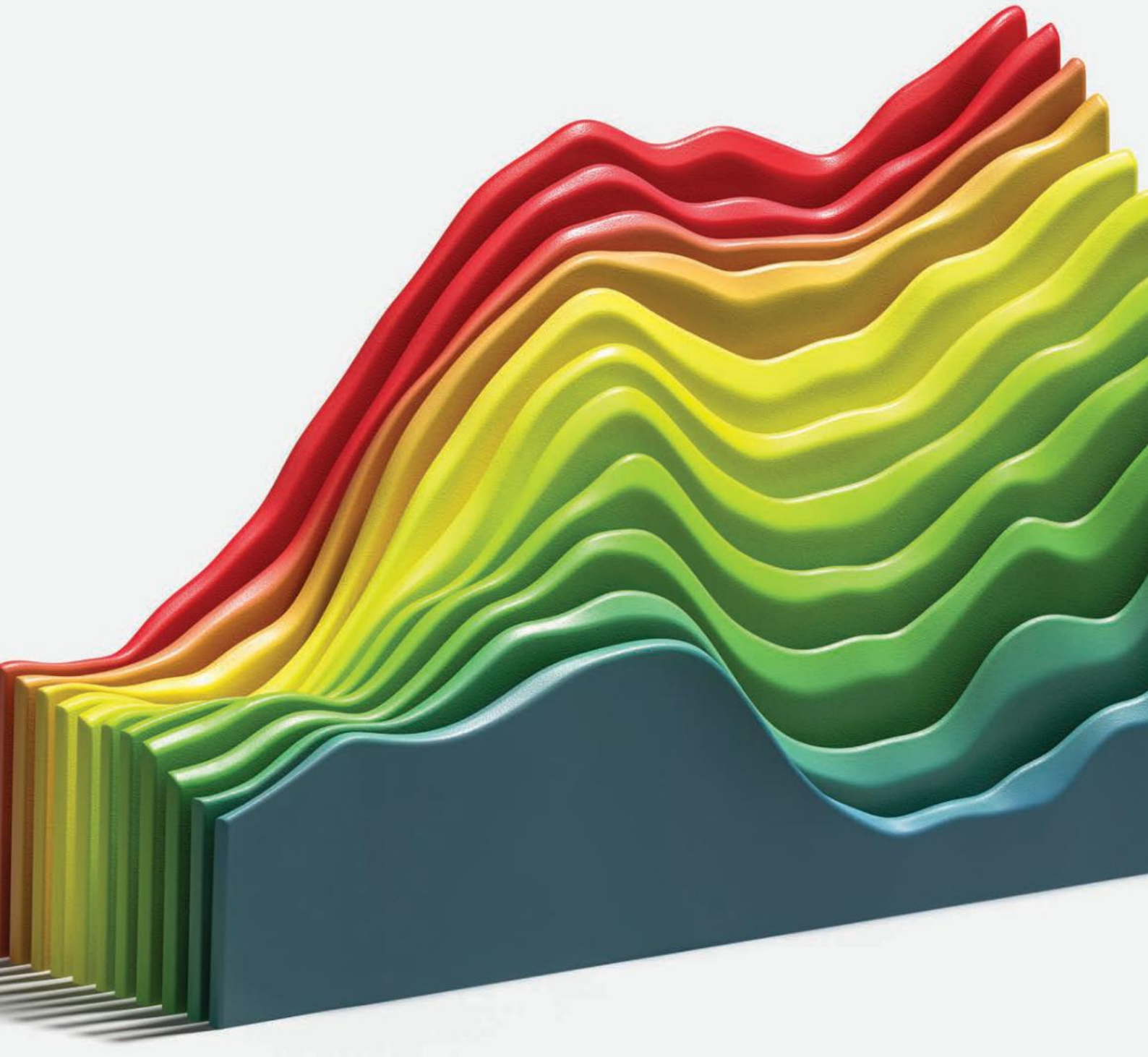
Stage 6 • Year 12

Fifth Edition



MARIANNE HICKEY • DORIAN KIPRIOTIS • TONY NADER • TIM WILLIAMS

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Overview

To the student

Welcome to the HSC component of *Cambridge Business Studies Stage 6 Fifth Edition*, a resource that builds on the knowledge and skills introduced in the Preliminary course.

The authors of this book, teachers in schools just like yours, have a shared desire to provide you with an informative and helpful resource written in language designed for students.

Make sure you consolidate each concept as it is covered; it will be too hard to master them all at once during the end-of-year revision. Activities and reviews that appear throughout chapters are designed to check your deep understanding of each concept. Even if your teacher doesn't set all tasks, these activities and reviews will provide an excellent opportunity for you to check how you are going. Extended-response questions at the end of chapters build your skills in this assessment type that students traditionally struggle with.

Use the QR codes in this book to access explanatory videos of some difficult concepts. In the digital component, you will also find auto-marked quizzes to help you check your recall of content.

Chapter summaries, as well as the unit and chapter concept maps, are excellent revision tools.

We wish you well with your studies this year!

The Authors.

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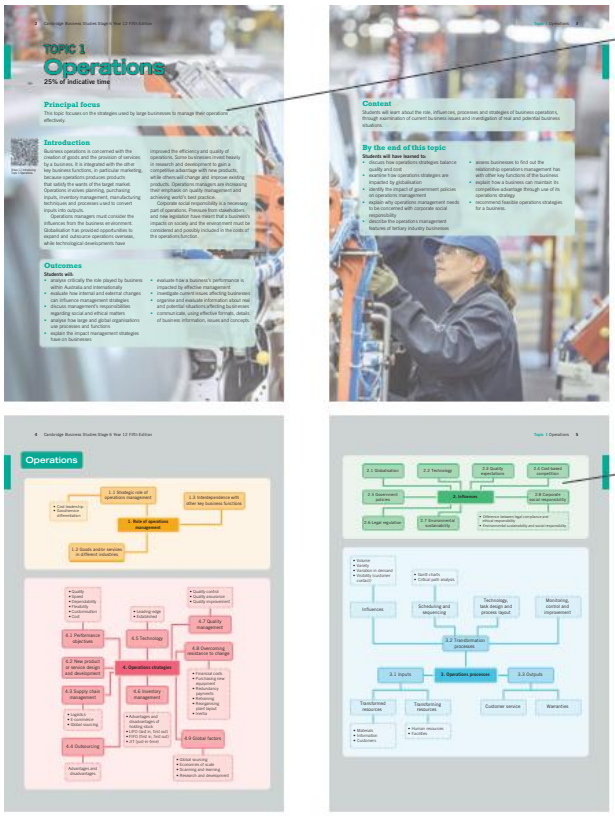
How to use this resource

Topic openers



Each topic starts with an overview that sets out:

The principal focus of the topic. A QR code enables you to watch a short video on this topic.

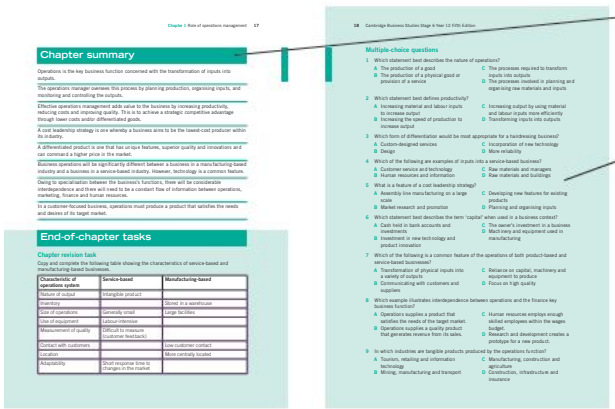
An introduction on the various aspects of the topic and how they fit together

The outcomes covered in the topic

The skills that students will acquire while working through the contents and executing the various activities

This is followed by a comprehensive concept map of the topic, illustrating how the various concepts interlink. The relevant sub-section of these concept maps appear within each chapter.

End-of-chapter materials



Each chapter ends with a summary of its most important learnings to assist you with your revision.

This is followed by questions assisting you with exam preparation, namely a chapter revision task, multiple-choice questions, short-answer questions and extended-response questions.

Icons

QR codes are included for easy access to related videos

Video available in the Interactive Textbook

For a list of the websites related to this book, go to www.cambridge.edu.au/busstudies125ed

Digital quiz
Please see the Interactive Textbook to access digital activities.

End-of-section questions are to be completed in the Interactive Textbook. There are two types: auto-marked quizzes identified by this icon and Review questions that are completed in Workspaces.

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TOPIC 1
Operations

25% of indicative time

Principal focus

This topic focuses on the strategies used by large businesses to manage their operations effectively.

Introduction

Video 1.1 Introducing Topic 1 Operations

Business operations is concerned with the creation of goods and the provision of services by a business. It is integrated with the other key business functions, in particular marketing, because operations produces products that satisfy the wants of the target market. Operations involves planning, purchasing inputs, inventory management, manufacturing techniques and processes used to convert inputs into outputs.

Operations managers must consider the influences from the business environment. Globalisation has provided opportunities to expand and outsource operations overseas, while technological developments have improved the efficiency and quality of operations. Some businesses invest heavily in research and development to gain a competitive advantage with new products, while others will change and improve existing products. Operations managers are increasing their emphasis on quality management and achieving world's best practice.

Corporate social responsibility is a necessary part of operations. Pressure from stakeholders and new legislation have meant that a business's impacts on society and the environment must be considered and possibly included in the costs of the operations function.

Outcomes

Students will:

- analyse critically the role played by business within Australia and internationally
- evaluate how internal and external changes can influence management strategies
- discuss management's responsibilities regarding social and ethical matters
- analyse how large and global organisations use processes and functions
- explain the impact management strategies have on businesses
- evaluate how a business's performance is impacted by effective management
- investigate current issues affecting businesses
- organise and evaluate information about real and potential situations affecting businesses
- communicate, using effective formats, details of business information, issues and concepts.

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Content

Students will learn about the role, influences, processes and strategies of business operations, through examination of current business issues and investigation of real and potential business situations.

By the end of this topic

Students will have learned to:

- discuss how operations strategies balance quality and cost
- examine how operations strategies are impacted by globalisation
- identify the impact of government policies on operations management
- explain why operations management needs to be concerned with corporate social responsibility
- describe the operations management features of tertiary industry businesses
- assess businesses to find out the relationship operations management has with other key functions of the business
- explain how a business can maintain its competitive advantage through use of its operations strategy
- recommend feasible operations strategies for a business.

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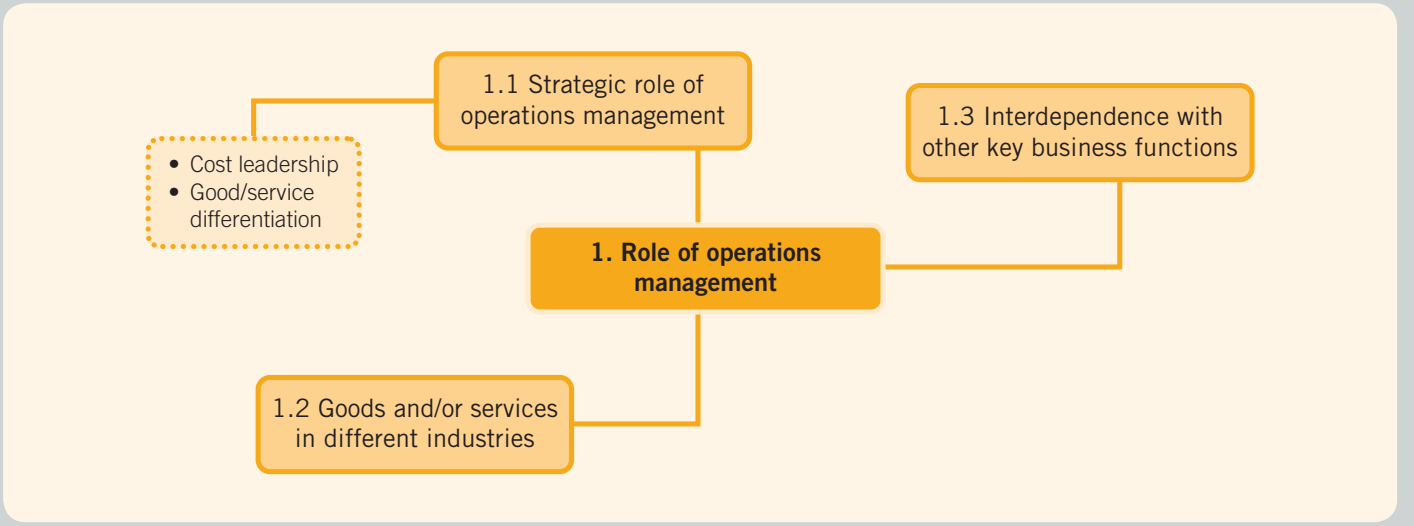
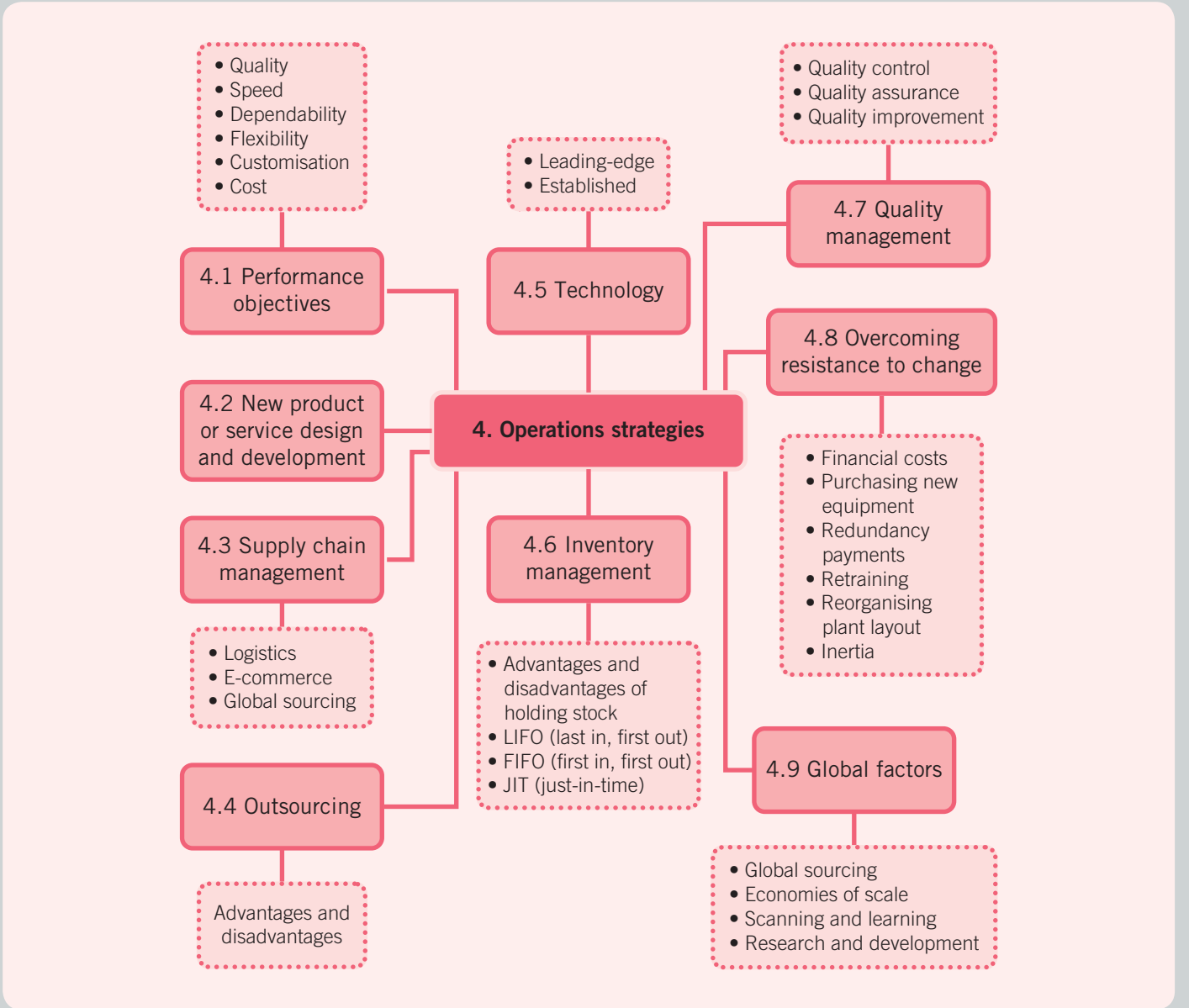
Operations





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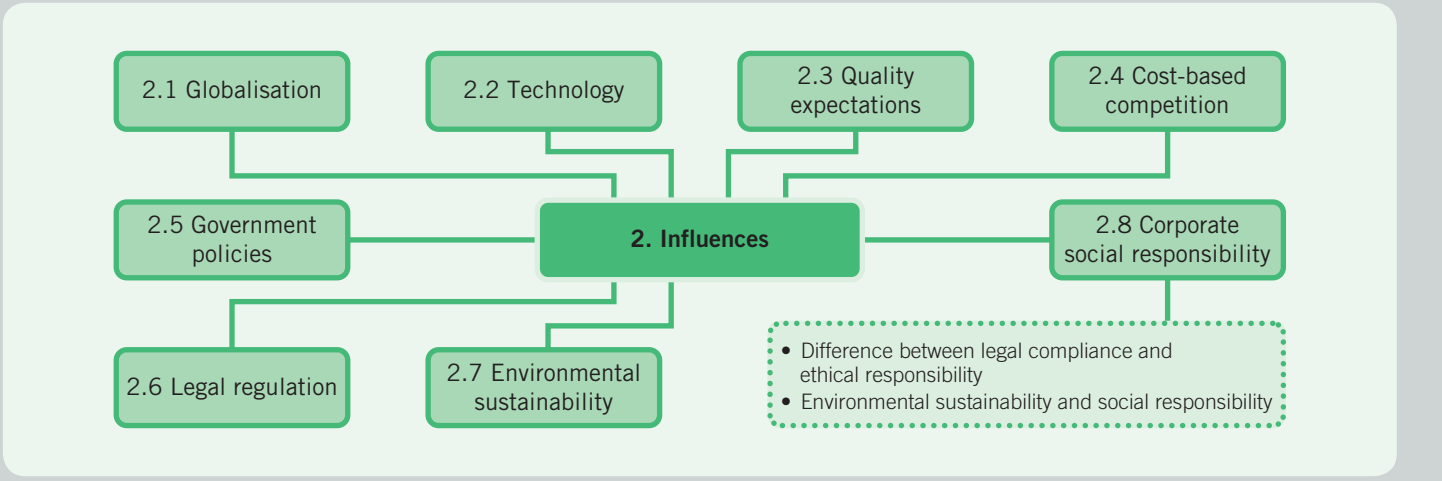

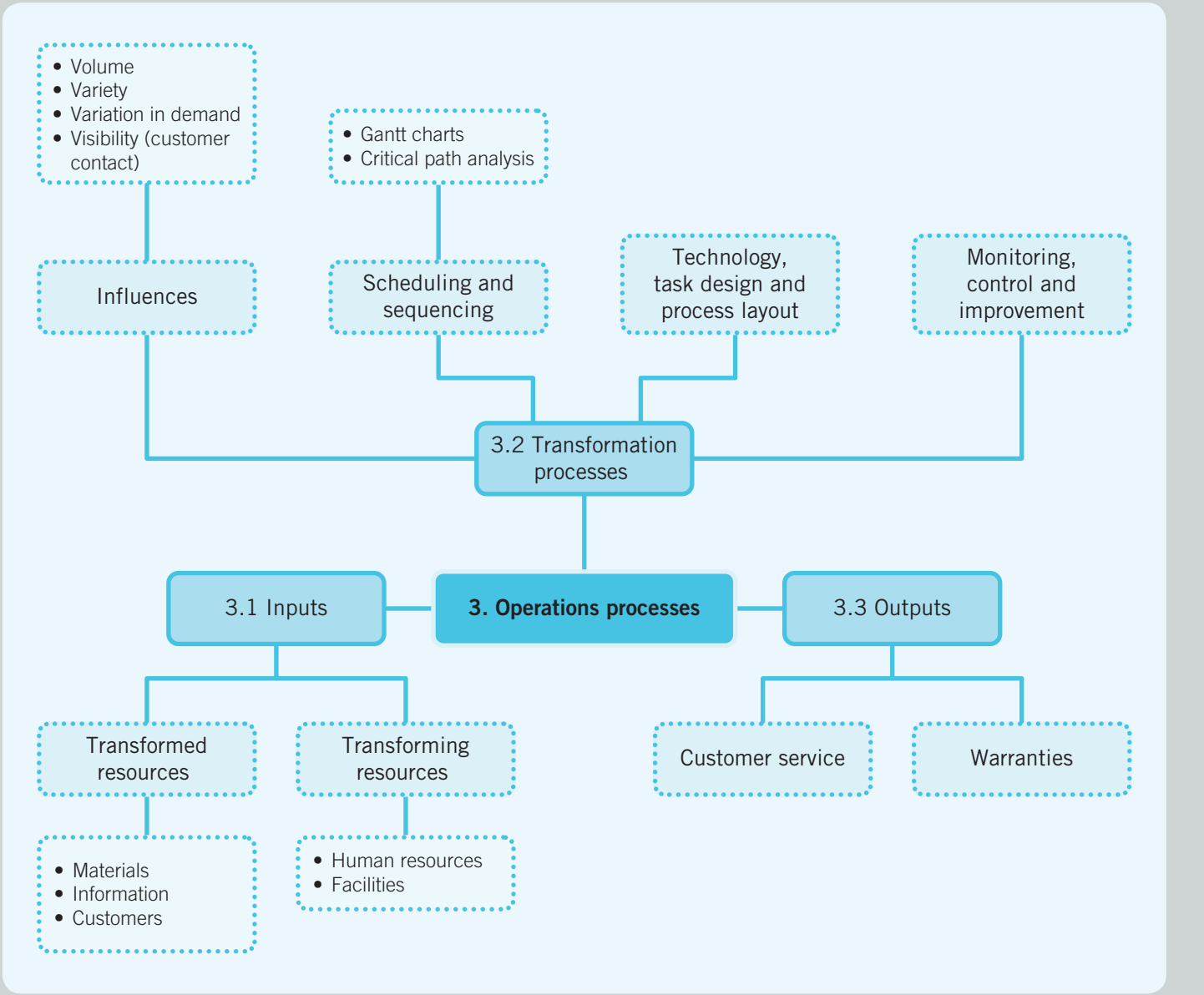

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1 Role of operations management

Chapter objectives

In this chapter, students will:

- examine the role played by the operations function in the overall strategic plan of a business
- identify the operations function
- examine the reliance of operations on the other key functions and on each other
- distinguish between a good and a service
- relate products to different types of industries
- examine the key role of operations in achieving a competitive advantage and efficiency for a business
- identify contemporary business issues
- investigate aspects of business
- analyse the operations process
- explain operations strategies and their impact on businesses
- evaluate the effectiveness of operations management.

Key terms

- competitive advantage
- customise
- economies of scale
- efficiency
- inputs
- interdependence
- outputs
- productivity
- profit margin
- specialisation
- strategic
- tangible
- transformation

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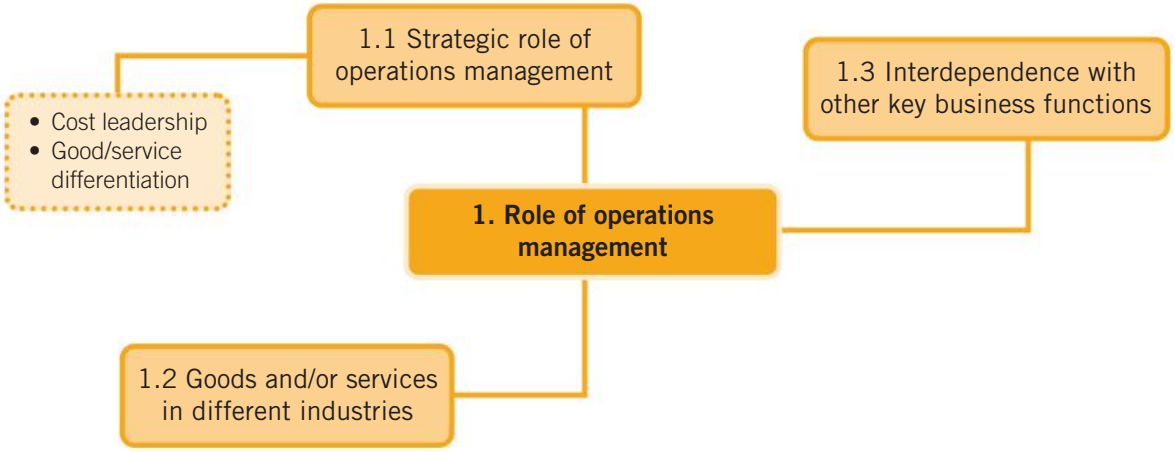
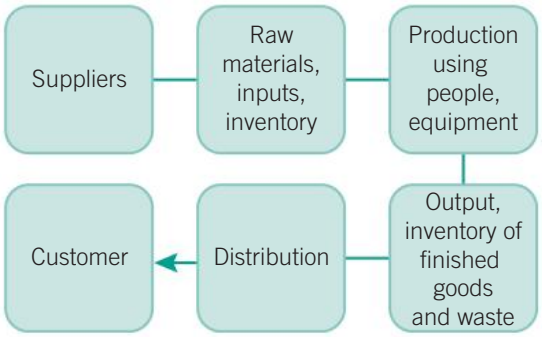
1.0 Introduction



Source 1.1 Role of operations management concept map

Operations is the business function concerned with the **transformation** of **inputs** into **outputs** (see Source 1.2). The operations manager oversees this process by planning production, organising inputs, monitoring the operations process and controlling the outputs. Outputs can be both physical goods and services. The output may be finished goods sold to final consumers, an intermediate good that will be used as inputs by other businesses or a service provided to consumers or businesses.



Source 1.2 A simplified operations process

Many businesses provide both a physical product and an associated service. For example, a restaurant will provide a good – the meal itself – and the waiting service to the customer's table.

Effective operations management adds value to the business by increasing **productivity**, reducing costs and improving quality. This is to achieve a strategic **competitive advantage** through lower costs and/or differentiated goods. The business can offer a better quality good at a cheaper price. To perform their role the operations manager will need all the skills and qualities discussed in Topic 2, Business management, of the Preliminary course – in particular, communication, decision-making, delegating and complex problem-solving. In a large business that uses a functional organisational structure, the operations manager will supervise specialist line managers (see Source 1.3). In a small business, operations may be managed by an owner, factory manager or sales manager.

Transformation Any change to inputs that adds value and converts them into outputs.

Inputs The raw materials, components and parts used to produce a good or supply a service.

Outputs What is made or supplied by the operations process.

Productivity A measure of how efficiently goods and services are produced. It is usually measured in terms of output per labour hour.

Competitive advantage Refers to the features implemented by a business that create an advantage over its competitors.

Source 1.3 Operations in a functional organisational structure

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Digital quiz
Please see the Interactive Textbook to access digital activities.

The operations manager will consider business operations as an entire system. A business must be able to produce goods and services that best satisfy the wants and needs of customers at a competitive price. Through their role, the operations manager can add value to the product at each stage of operations. Ultimately, with an effective and efficient operations system a business will achieve the short-term and long-term objectives of the business, primarily profit.

Source 1.4 An effective operations system adds value at each stage of the operations.

1.1 Strategic role of operations management

The operations manager is responsible for **strategic** decisions about how the operations system functions. A strategic decision is one that affects the business in the long term. For example, where the business chooses to make its products will affect the location of operations or decisions about where the business gets its inputs from. Will the business buy inputs and raw materials from a local supplier or look offshore and buy from another country? The strategic goals of operations are to improve productivity, **efficiency** and quality of outputs. Strategic operational decisions will also need to suit the overall strategic goals and vision in the business plan and fit the changing business environment (see Source 1.5).

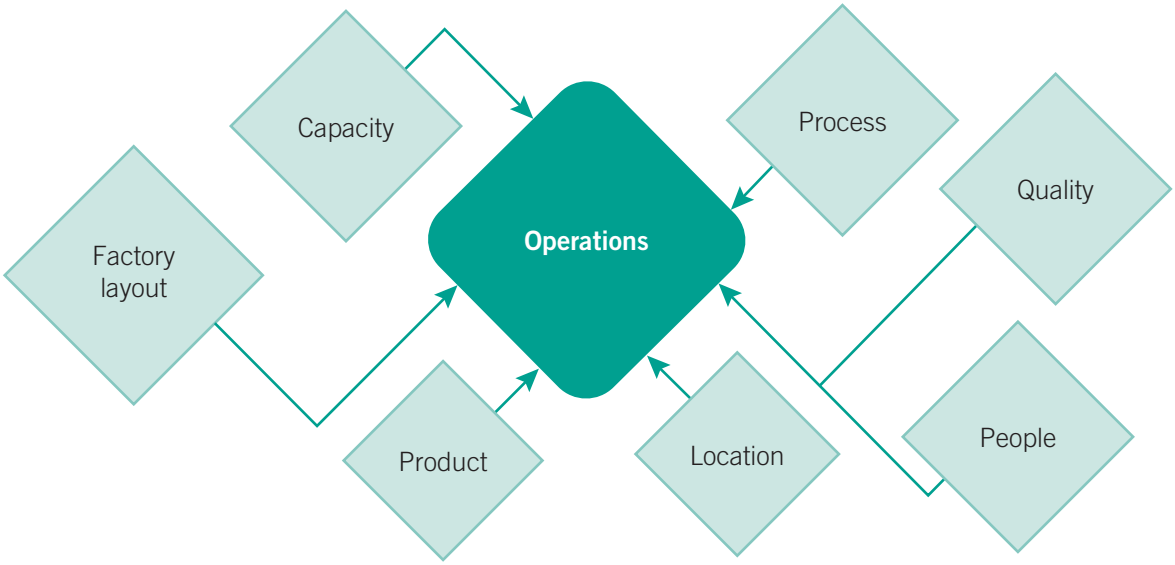
Strategic Used to describe long-term planning performed by senior managers.

Efficiency The achievement of maximum output with the minimum level of inputs. It involves achieving an objective without wasting resources and while keeping costs as low as possible.

There are three general areas of long-term decision-making:

- planning production and delivery
- controls to manage quality
- improving operations.

Therefore, all strategic decisions will focus on lowering costs by being efficient and producing a good or service that is different from and competitive against those of rivals in the market (see Source 1.6).



Source 1.5 Strategic decisions about how operations will be managed

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Source 1.6 Strategic decisions

Area of strategic decision	Examples of decisions to make
Product	What new products need to be developed?
	What products are reaching the end of their life cycle and need to be deleted?
	How will products be made different from those of competitors?
	What services will be provided?
Process	How much capital and how much labour will be needed?
	What developments in technology will there be that could be used in operations?
Capacity	How large does the factory need to be?
	How much equipment will be needed?
	How much will the business need to make and supply per hour or day?
Location	Stay, move to a different location in Australia or overseas, or outsource?
	Can the business provide its services using the internet?
Factory layout	How will manufacturing be physically set out?
People	How many employees will be needed in the future?
	What experience, skills and qualifications will employees need?
Quality	How will quality be measured?
	How will quality be improved?

Cost leadership

A cost leadership strategy is one in which a business aims to be the lowest-cost manufacturer within its industry. The products are basic with fewer features, perhaps of lower quality and using low-cost packaging. Low costs can be achieved through **economies of scale** in production and distribution, access to cheaper raw materials or by using technology. The business will expect a small **profit margin** on each item it sells, balanced by a high volume of sales to generate revenue.

Other areas in operations where low costs may be achieved include:

- outsourcing product servicing so that the business focuses on its core function rather than after-sales service and warranty administration
- exclusive access to a large source of low-cost inputs
- distributing the product using dealers who work with lower profit margins.

If the business is able to achieve cost leadership and sustain it over the long term, and is also able to sell its products at prices below those of its competitors, then it will be an above-average performer with healthy sales and profits. Australian businesses need to use a cost leadership approach to be competitive against cheaper imported products.

Economies of scale By increasing the scale of operations, a business can lower the cost of producing each individual output as a result of cost savings and greater efficiency.

Profit margin The difference between the sale price of a product and the cost to make the good or supply the service.

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Business Bite

Around the year 2000, low-cost fashion was rapidly growing. Online shopping and consumer tastes for the latest styles from the top fashion houses and catwalks enabled brands such as H&M, Zara and Topshop to expand globally. Global supply chains meant consumers could easily purchase cool, trendy clothing for very low prices, wear it a few times and then throw it away. Producers used offshore manufacturing where labour was the cheapest with cheap, low-quality material inputs. Operations were highly flexible to incorporate feedback from marketing about changing styles and trends so that these were available with very short turnaround times between when a trend was first seen to when it was available. Thousands of styles could be produced, each in limited numbers. Customers learned that if they did not buy something immediately they would miss their chance, understanding that the clothes degrade after just a few wears and get thrown away.

Source 1.7 Employees process coats at a garment factory in China.

Challenges to business

The challenge for a business using the cost leadership strategy is to achieve long-term benefits. Operations managers need to be aware of the following issues when using this strategy:

- Competitors can use the same strategy and may achieve even lower costs.
- Small businesses are able to implement strategies to reduce costs much faster than larger firms.
- The business's product may be perceived by customers to be of poor quality compared to those of its competitors because competitors offer better technology, features and service.
- Developments in technology may change consumer preferences. A business may have invested a considerable amount of finance into low-cost manufacturing of a particular product only to find that the wants of its customers have changed to a new technology item.
- Consumer preferences may change and the market for a 'low-cost, low-quality' product may shrink. Consumers may even feel that these types of 'throwaway' products are not environmentally sustainable.
- A competitor may use aggressive marketing with heavily discounted prices or loss-leading prices. The business using a cost leadership strategy cannot then make a profit, even with its cost advantage.
- A business can be 'leapfrogged' by another business that can afford a large financial investment in research and development.

A cost leadership strategy may not be sustainable in the long run unless the benefits can be maintained with effective marketing, finance and human resource strategies. Therefore, operations is interdependent with the other business functions.

Ethical Spotlight 1.1

In an attempt to lower prices and still maintain their own profit margins, some businesses have placed excessive pressure on their suppliers to cut their prices to the retailer (for example, in the dairy industry). Is it ethical to reward consumers with lower prices when the businesses creating these products are facing an unsustainable future?

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Good/service differentiation

A business may decide that a better strategy to achieve a sustainable advantage in a competitive market is to differentiate its products rather than aiming to be the lowest-cost supplier. Customers have ever-increasing expectations about quality, service and technology. Therefore, a product may achieve a greater market share because it is uniquely different from its competitors' products.

Differentiation through operations may be achieved through:

- better quality
- faster delivery
- custom-designed products
- more features and applications
- incorporation of new technology
- more reliability
- clever design.

Business Bite

Technological innovation has created opportunities for businesses to specialise in information technology (IT) services to other businesses. Data analytics services use automated algorithms to analyse raw data so that managers can make better decisions and optimise the performance of key business functions such as operations and marketing.

In operations, data on production times, quality and work queues for different machines can be analysed to better plan production to increase productivity and reduce costs of the whole operations processes to operate at maximum capacity. Data analytics can do much more than point out bottlenecks in production.

IBT (Integrated Business Technologies) is an Australian IT professional services firm founded in 1997 and a key player in the market for business data services. Its clients include the Reserve Bank, the Department of Defence and Wesley Mission.

Differentiation strategies

Good examples of a differentiation strategy are the voice recognition software and 'touchscreen' technology used in Apple products such as iPhones and iPads.

A differentiated product can command a higher price in the market because customers are attracted to the product and loyal to the brand. The higher price will cover expenses incurred from investment to research and develop new products. A sales team will promote the advantages of the product and its technological innovation.

The risks associated with this strategy are that competitors can imitate the market leader's innovations and consumer preferences can still change.

Source 1.8 Uber has successfully achieved differentiation by utilising smartphone applications.

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Review 1.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Identify two alternative terms that can be used instead of 'transformation'.

2 Explain how a business can use operations to achieve a competitive advantage.

Examine the advertisement for an operations manager below to answer questions 3 and 4.

Operations manager

Hunter Valley Coal Ltd is seeking a talented operations manager with a background in mineral processing facilities. Applicants will need effective communication, organisation and negotiation skills as well as the ability to take a hands-on, practical approach to work. Technical knowledge of operations and related equipment is essential. Key areas of responsibility include implementation of health, safety and environmental policies and ensuring production meets targets. The role will oversee the expansion and automation of key aspects of coal processing.

Industry-leading remuneration and compensation for relocation will be provided.

Applications are to be directly submitted to the CEO of Hunter Valley Coal, Newcastle, NSW.

3 Explain why a manufacturing business may need to make strategic decisions about capacity.

4 Explain why an operations manager needs to consider the entire business when making decisions.

1.2 Goods and/or services in different industries

There are significant differences between manufacturing and service-based businesses. Manufacturing outputs are **tangible**; that is, they physically exist and can be touched and felt. Therefore, the outputs can be stored before being distributed to customers; however, once made, they cannot be changed or **customised**. The productivity of the business making the goods is easy to measure, as physical goods can be counted. Services, in contrast, are not tangible. For example, services like financial advice, a doctor's consultation or representation in court by a barrister are real but do not exist in a physical sense. While manufactured goods use a lot of equipment – that is, they are very capital-intensive – services are much more labour-intensive. Services require a lot of interaction with customers who consume the service where it is provided (for example, at a hair salon). The advantage of services over manufacturing is that it is easy to modify and customise the service to suit the desires of the customer.

However, productivity is much harder to measure due to each service being different for different customers.

Tangible Able to be seen and felt.

Customise To change the features of a product to suit the precise preferences of a customer.

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A business can provide a physical good or a service, and very often provides both. There are also similarities between service-based and manufacturing operations. They both:

- use technology
- make predictions about consumer demand
- deal with customers and suppliers
- make decisions about capacity, location and physical layout of the business.

There is a great variety in the output of the operations of different businesses. Grouping different businesses by sector and industry gives a good indication of the range of goods and services in different industries. Changes to the nature of each industry are occurring with technological change (see Source 1.10).

Source 1.9 Hairdressers provide labour-intensive services.

Source 1.10 Australian industry classifications

Classification	Description	Examples
Primary	Businesses involved in the acquisition of raw materials, including natural resources	Agriculture, mining, fishing
Secondary	Businesses that use raw materials as well as labour and capital equipment to create finished products	Construction, engineering, factories, craft
Tertiary	Businesses whose prime function is related to providing a service	Hairdressers, doctors, engineers, nurses
Quaternary	Tertiary sector businesses that provide information services to their customers and businesses, which enable the transfer of information	Banks, the media, telecommunications companies
Quinary	Tertiary sector businesses that provide services traditionally performed in the home	Takeaway food restaurants, home-maintenance businesses, cleaning businesses, childcare centres

Source 1.11 Australian industry sectors

Sector	Example	Nature of the goods and services	Industry
Agriculture	Cubbie Station	Australia's largest cotton producer, located in Queensland	Primary
Banking and finance	Macquarie Bank	Provides banking, finance, advisory and investment services for businesses	Tertiary
Construction and engineering	Brookfield Multiplex	Construction and development of large buildings and major projects	Secondary
Education	Bond University	Australia's first private, not-for-profit university, located in Queensland	Quaternary

Continued →

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Source 1.11 *Continued*

Sector	Example	Nature of the goods and services	Industry
Food and beverage manufacturing	Coca-Cola Amatil; Arnott's	Manufacturer and bottler of a range of non-alcoholic and alcoholic drinks; biscuit and snack food maker founded in 1865	Secondary
Health care	Douglass Hanly Moir	Medical testing laboratory services and pathology services	Quaternary
Information technology	YourDC	Provides innovative data storage, management and security systems	Quaternary
Infrastructure and utilities	AGL Energy	Provides natural gas and electricity energy for homes and businesses and energy services	Secondary
Insurance	NRMA	All types of business and personal insurance as well as motoring services	Tertiary
Legal	Herbert Smith Freehills	Ranked in the top eight of Australian law firms providing commercial legal advice and pro bono services	Tertiary
Leisure and gaming	Aristocrat	Supplies slot machines, gaming systems, accessories and services worldwide	Secondary
Manufacturing	CSR Building Products	Founded in 1855 as the Colonial Sugar Refining Company; now manufacturer of building materials: aluminium, brick, glass and plasterboard	Secondary
Media	Nine Entertainment Co.	Owns Nine Network and 9Now, Stan (subscription video), Domain Group (real estate media), and the newspapers *The Sydney Morning Herald*, *The Age* and *Australian Financial Review*	Tertiary
Mining and energy	BHP	Began in Broken Hill, New South Wales, in 1885, mining silver, lead and zinc; merged with Billiton in 2001 to be global leader in the resources industry	Primary
Property	Westfield	Shopping centres still branded Westfield; however, Westfield Group taken over by Unibail-Rodamco (European commercial real estate company) in 2018	Tertiary
Retail	Harvey Norman Holdings	Operates in Australia, New Zealand, Slovenia, Ireland, Singapore and Malaysia, offering franchises within the store to retailers of home and office products	Tertiary
Small business	7-Eleven	Convenience stores first opened in Australia in 1977; over 700 stores spread across Queensland, New South Wales, the Australian Capital Territory, Victoria and Western Australia	Tertiary
Telecommunications	Telstra	Formerly a government business enterprise, privatised from 1997, providing landline, mobile and internet services with interests overseas	Quaternary
Tourism	Hamilton Island Enterprises	Leading resort located in the Whitsunday Islands, Great Barrier Reef	Tertiary
Transport and logistics	Qantas	Provides transport through its two-brand strategy, Qantas and Jetstar; air freight services are also offered	Tertiary

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Review 1.2

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Outline one way operations in a restaurant can add value to a business.
2 Outline the mix of goods and services provided in the hospitality industry.
3 Briefly explain the 'make or buy' strategic decision.
4 Explain how a beverage manufacturing business can achieve product differentiation through operations.
5 Analyse the impact of changing consumer tastes for healthier food on food manufacturing.

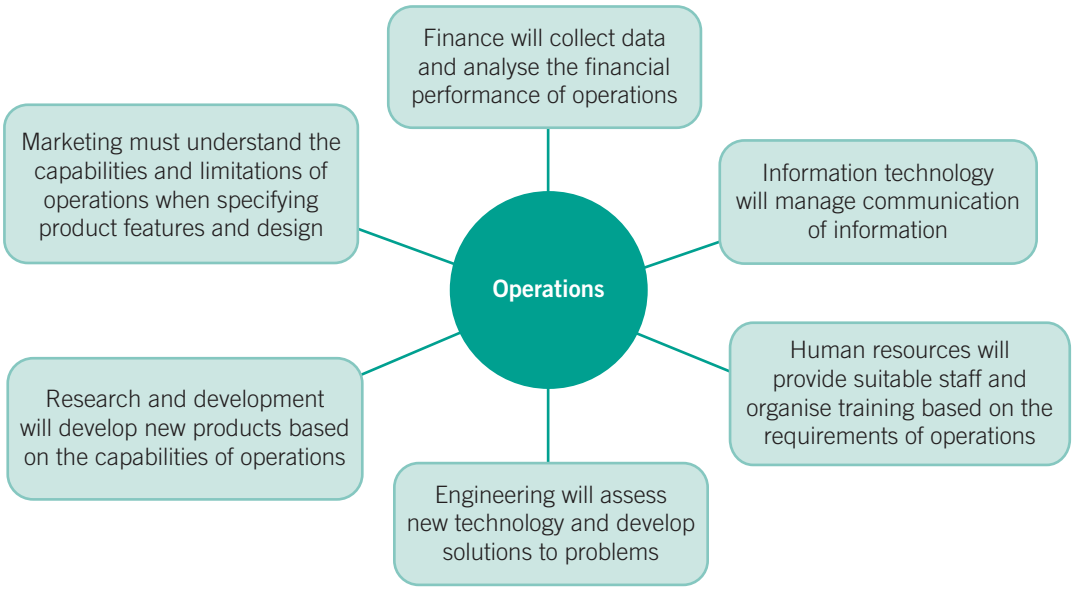
1.3 Interdependence with other key business functions

There will be a constant flow of information between operations and the other key business functions: marketing, human resources and finance. Each function relies on the others so that the business can achieve its goals. Therefore, with **specialisation** of the business functions there must be **interdependence** (see Source 1.12).

To illustrate the interdependence between the key business functions, consider the following interactions between each. In marketing, research identifies the features of a good that consumers desire and marketing strategies are developed to encourage purchases of that good. Operations must produce and supply a product that has the features and quality consumers demand as well as reliably distribute the product to the market. Innovation may be required in operations to create products as specified by marketing. The finance manager will create budgets and make funds available to purchase inputs and equipment, make repairs and perform routine maintenance. Operations will seek to keep under budget in order to maximise profit margins. Operations managers will inform human resources of the skills and experience it needs its workers to have. Human resources will ensure that enough employees with the appropriate skills are available for the operations function and provide training if needed. The human resource manager will use their leadership style and rewards to ensure quality work is done by employees in the operations function.

Specialisation A high level of skill at a specific task or role.

Interdependence The reliance of different parts of an organisation on each other to perform their task or role.



Source 1.12 The interdependence between operations and other business functions

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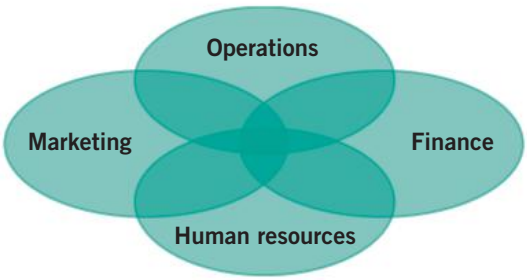
Changing operations will have impacts on the other key business functions. Changes in the costs of production may lead to higher prices, affecting marketing. Human resources will need retraining and some employees may be made redundant. Finance will be needed to purchase new technology, machinery and inputs. Changes in operations may take time and interrupt production, reducing profitability.



Source 1.13 The interdependence between the key business functions

Review 1.3

Comprehension

Answer these questions on paper or in the Interactive Textbook.

Identify which manager would require the following information from the operations manager.

1. Data to calculate costs of operations
2. Product quality measures
3. Skills and expertise of operations employees
4. Purchase costs of new equipment and inputs
5. Employee productivity data
6. The original purchase price, depreciation rate, and current location of all equipment, machinery and other assets used in operations
7. The products' capabilities and features

Source 1.14 Marketing must understand the limits of the operations function to avoid specifying unrealistic product features and designs like this flying car.

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Chapter summary

Operations is the key business function concerned with the transformation of inputs into outputs.

The operations manager oversees this process by planning production, organising inputs, and monitoring and controlling the outputs.

Effective operations management adds value to the business by increasing productivity, reducing costs and improving quality. This is to achieve a strategic competitive advantage through lower costs and/or differentiated goods.

A cost leadership strategy is one whereby a business aims to be the lowest-cost producer within its industry.

A differentiated product is one that has unique features, superior quality and innovations and can command a higher price in the market.

Business operations will be significantly different between a business in a manufacturing-based industry and a business in a service-based industry. However, technology is a common feature.

Owing to specialisation between the business's functions, there will be considerable interdependence and there will need to be a constant flow of information between operations, marketing, finance and human resources.

In a customer-focused business, operations must produce a product that satisfies the needs and desires of its target market.

End-of-chapter tasks

Chapter revision task

Copy and complete the following table showing the characteristics of service-based and manufacturing-based businesses.

Characteristic of operations system	Service-based	Manufacturing-based
Nature of output	Intangible product	
Inventory		Stored in a warehouse
Size of operations	Generally small	Large facilities
Use of equipment	Labour-intensive	
Measurement of quality	Difficult to measure (customer feedback)	
Contact with customers		Low customer contact
Location		More centrally located
Adaptability	Short response time to changes in the market	

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Multiple-choice questions

1 Which statement best describes the nature of operations?

A The production of a good
B The production of a physical good or provision of a service
C The processes required to transform inputs into outputs
D The processes involved in planning and organising raw materials and inputs

2 Which statement best defines productivity?

A Increasing material and labour inputs to increase output
B Increasing the speed of production to increase output
C Increasing output by using material and labour inputs more efficiently
D Transforming inputs into outputs

3 Which form of differentiation would be most appropriate for a hairdressing business?

A Custom-designed services
B Design
C Incorporation of new technology
D More reliability

4 Which of the following are examples of inputs into a service-based business?

A Customer service and technology
B Human resources and information
C Raw materials and managers
D Raw materials and buildings

5 What is a feature of a cost leadership strategy?

A Assembly line manufacturing on a large scale
B Market research and promotion
C Developing new features for existing products
D Planning and organising inputs

6 Which statement best describes the term 'capital' when used in a business context?

A Cash held in bank accounts and investments
B Investment in new technology and product innovation
C The owner's investment in a business
D Machinery and equipment used in manufacturing

7 Which of the following is a common feature of the operations of both product-based and service-based businesses?

A Transformation of physical inputs into a variety of outputs
B Communicating with customers and suppliers
C Reliance on capital, machinery and equipment to produce
D Focus on high quality

8 Which example illustrates interdependence between operations and the finance key business function?

A Operations supplies a product that satisfies the needs of the target market.
B Operations supplies a quality product that generates revenue from its sales.
C Human resources employs enough skilled employees within the wages budget.
D Research and development creates a prototype for a new product.

9 In which industries are tangible products produced by the operations function?

A Tourism, retailing and information technology
B Mining, manufacturing and transport
C Manufacturing, construction and agriculture
D Construction, infrastructure and insurance

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10 Which of the following does NOT illustrate how the operations function relies on the other key business functions?

A Human resources ensuring new employees have appropriate qualifications
B Marketing providing feedback from customers about product quality
C Finance manager setting efficiency targets for operations
D IT manager using operations data to identify areas for improvement

Short-answer questions

1 Explain why the operations of service-based industries are more labour-intensive than those of manufacturing businesses.

2 Analyse the impacts of the operations function on the achievement of a business's financial objectives.

Extended-response question

Compare and contrast the operations of a health-care provider with those of a large-scale furniture manufacturer.

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2 Influences

Chapter objectives

In this chapter, students will:

- investigate the impact of globalisation
- analyse the impact of external influences on operations
- analyse the impact of government policies on operations management
- evaluate the role of corporate social responsibility.

Key terms

- common law
- computer-aided design (CAD)
- computer-aided manufacture (CAM)
- depreciation
- globalisation
- Jugaad
- regionalism
- robotics
- social responsibility
- tax concession
- technology
- trading bloc

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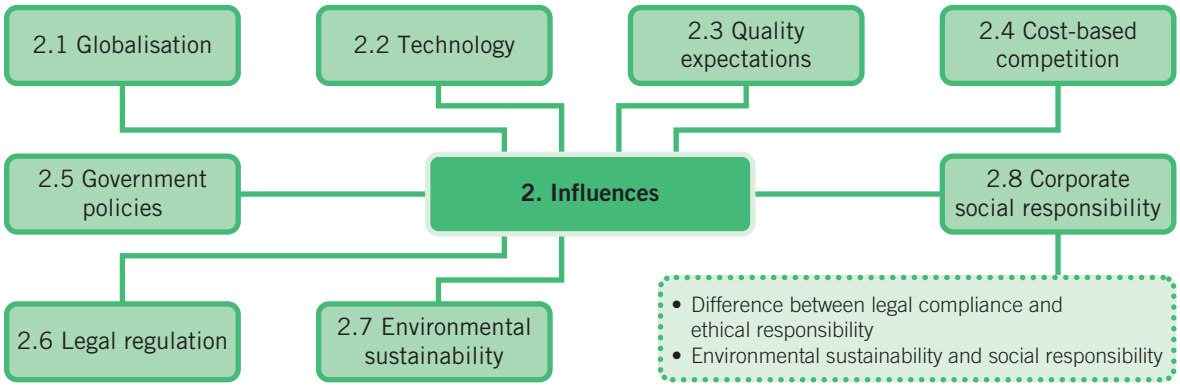
2.0 Introduction



Source 2.1 Influences concept map

Every aspect of business is influenced by its dynamic external environment, and the operations function is no exception. Influences on business operations include globalisation, technology, customers' quality expectations, cost-based competition, government policies, legal regulation and environmental sustainability. In addition, business operations are shaped by the requirements of corporate social responsibility.

These influences can provide opportunities for improvements to the operations process and strategies. However, they can also threaten the ability of a business to achieve its objectives for operations.

Source 2.2 Business is influenced by many factors, including environmental sustainability.

2.1 Globalisation

Globalisation gives consumers the opportunity to purchase products from the business that provides the most value for money. It is highly likely that students doing their Business Studies homework will be using a pen made by a French company and checking their social status on a Chinese laptop while having some two-minute noodles made by one of the world's largest consumer packaged goods companies, based in Switzerland.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Globalisation Different national economies integrated into one market for easy trade of goods and services, and the development of a world economy owing to the increasing flow of goods, services, people, finance and information around the world.

Businesses operate in a dynamic and highly competitive global environment, which has a marked effect on business operations. Globalisation has significantly influenced location decisions by making it possible to reduce costs, because businesses can locate closer to their sources of raw materials and where labour is less expensive. Governments of developing nations where these resources are in abundance may offer incentives, such as low tax rates, to attract businesses.

Globalisation has created many opportunities for Australian businesses to expand into overseas markets. This may be as simple as importing materials or establishing operations in a country where it is cheaper to produce goods. Therefore, the impacts of globalisation are twofold. First, there is the opportunity to reduce costs and improve quality through establishing a global supply chain. Second, there is access to a global market to sell the outputs of operations.

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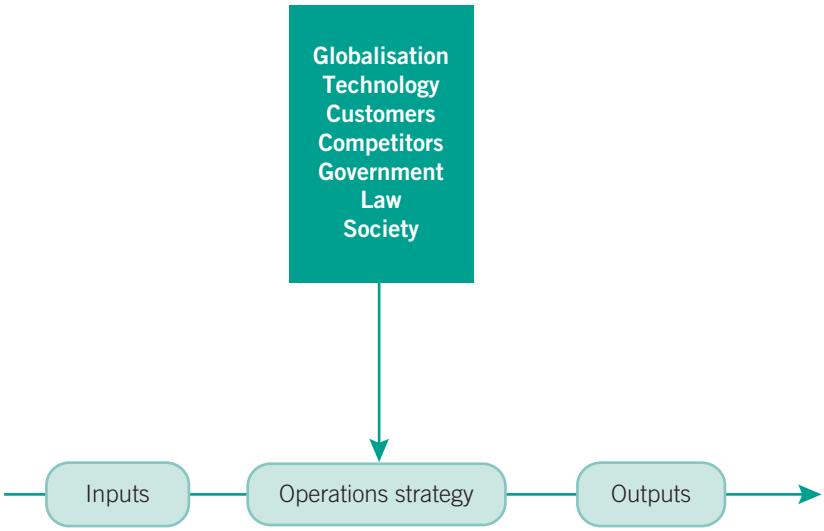

Source 2.3 External influences on operations

Global businesses

Globalisation is defined as the integration and interdependence of the economies of different countries, creating a global economy. Integration refers to the joining together of different economies through trade, technology, deregulation and development of global businesses.

As a result, there is an increasing flow of goods, services, people, finance and information around the world. Any business that has a key business function outside its home nation is part of the global economy. Geographic location and distance have become much less important issues for business. Technology, in particular, has made it easier and cheaper to communicate and transport inputs and outputs throughout the different divisions of the business that are located in different countries.

Global businesses are fully integrated into the global economy, usually with each business function operating outside the home nation. Manufacturing may be located where inputs and labour are cheapest, such as in a developing country. Raw materials may be sourced from where they are most abundant. Finance is controlled from headquarters situated in one of the world's financial centres (for example, New York or London). Outputs may be distributed and sold to consumers in developed nations, such as Canada, Germany and the United Kingdom.

The point of a global web of operations is to force down costs and exploit the competitive advantage offered by each region. Different nations are known for having particular strengths that businesses wish to use, and there can be a competitive advantage. Examples are shown in Source 2.4.

Source 2.4 Comparative advantages of selected countries

Country	Advantage
Japan	Technological innovation
Italy	Contemporary design
India	A computer-literate workforce
Vietnam	Inexpensive labour
Mexico	Skilled labour in manufacturing

With globalisation, every function can be outsourced or relocated to reduce costs. For instance, the iPad produced by Apple Inc. is designed in the United States, using Japanese electronic parts, and assembled in China. This is an example of a high-quality and very successful product that represents the movement of businesses towards a global platform for the design, manufacturing and distribution of a product.

With opportunities to establish a global supply chain, many businesses expand into countries that offer cheaper labour, tax incentives and other benefits. This strategy will expose the business to additional influences brought about by different

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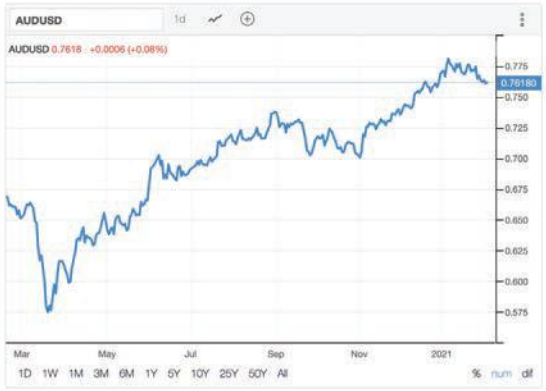
currencies, trade agreements, global consumers, technology and differences in cultures.

Different currencies

Operating in multiple countries, a business will have to convert currencies in order to pay suppliers for inputs. The value of different currencies is affected by the level of economic growth and confidence in the economy. This influence will principally affect the finance function of the business. Imagine an Australian manufacturing business that imports parts into Australia. A **depreciation** of the Australian dollar (AUD) against the currency of the country that inputs are being sourced from will lead to rising costs. The original advantage of relocating and outsourcing will be eroded by the falling value of the AUD in global finance markets. The business may be forced to seek a supplier elsewhere in the world where the AUD has a higher value, or accept higher costs for operations.

Financial risks can also occur if the AUD becomes very volatile, with frequent and unpredictable changes to its value.



Source 2.5 Depreciation of the Australian dollar will lead to rising costs.

A business can reduce this risk by using hedging. Hedging is any strategy used by a business to reduce financial risk. In this case, the risk is from the exchange rate falling between the time a purchase contract is signed and the time payment is made. Global businesses can use hedging to eliminate the risks caused by depreciation of the AUD. Global businesses often use derivative contracts as a form of hedging to buy and sell foreign exchange to purchase inputs from businesses in other countries.

Hedging can also be achieved naturally, without contracts, by using subsidiary businesses and suppliers. A subsidiary is a business owned by a larger business. A global business may have subsidiaries in different countries, but conduct all transactions in the same currency. For example, a toy manufacturer in the United States may own an electronics company in Malaysia that exports parts to be put into the toys. Transactions are always in US dollars to reduce currency exchange risk.

Trade agreements

Depreciation (of currency) A fall in the value of a nation's currency against that of another currency. A nation's currency can fall in value due to a poorly performing economy or inflation. Currencies of other countries may increase in value because their economies are performing better.

A bilateral trade agreement is similar to a treaty between two countries to reduce barriers to trade and promote economic integration. Multilateral trade agreements are between more than two nations. What is important for a global business wishing to enter the market is the number of barriers to trading that exist. Nations may reduce barriers between one another or they may place additional barriers to the entry of an outsider. A business may establish operations within a country that is a member of the same trade agreement. However, it may find it very expensive or prohibitive to establish operations within a country that is not part of the trade agreement.

Therefore, it may be easier for the business to establish overseas in that country than in a country with which no trade agreement exists. Some countries will develop a common trade policy against businesses in non-member countries. As a result, there is an increase in geographic **regionalism** in the world. As well as global trade and international flows, there are regions of the globe forming an economic alliance. Europe, North America and the South-East Asian nations (including China) are three examples of regions. All or some of the nations in a region may reduce the trade barriers between them, creating a regional **trading bloc** such as

Regionalism The classification of the world's nations into different regions based on their geography and economic links. The different regions may be classified as North America, Europe, South-East Asia, Asia–Pacific, Africa and South America.

Trading bloc A group of nations that have formed a trade alliance by signing a multilateral trade agreement.

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the European Union and the United States–Mexico–Canada Agreement (USMCA). There are important implications for Australian businesses if they are excluded from these economic 'clubs'. For example, Australian businesses will have to source inputs and components from other countries and will find it very difficult to export to countries where Australia is not a member of the trade agreement.

With the growth of the World Trade Organization (WTO) there has been a similar growth in global business, joint ventures, strategic alliances, foreign subsidiaries and multinational corporations, all creating a highly competitive global market. By using a large-scale operations model, businesses can share costs and reduce the expense of developing, producing and distributing products to the global market.

Video 2.1 Different types of trade agreements

Ethical Spotlight 2.1

Consider the implications of preventing some nations from trading with each other. Is this fair? Why?

Activity 2.1
Discussion

1 What is Brexit?
2 Analyse the impact of Brexit on businesses that operate in both the United Kingdom and Europe.

Business Bite

The benefits of free trade agreements are obvious, and the Australian Government is a keen supporter of open markets. Agreements provide new export opportunities for farmers, businesses and investors as well as less expensive imported inputs and finished products. Australia has a number of new agreements with its trading partners. In 2020, agreements with Indonesia, Peru and Hong Kong came into force. This is in contrast to many nations that have become more internally focused in the face of global 'shocks' and have raised the level of protection for their domestic industries. The use of tariffs and other methods of protection has increased in the G20 (highly developed) countries since the Global Financial Crisis and has been reinforced with Brexit, slow economic growth in Europe, and the US–China trade war. Donald Trump, who from 2017 to 2021 was the leader of the largest economy in the world, believed that protection was key to building prosperity and strength for America. In parts of Europe, politicians who support protectionism have gained more political power, while France and Germany have been shifting in recent years to more nationalistic economic strategies. The world is increasingly becoming more regional, and it may lose many of the benefits gained from free trade. The uncertainty created may impact Australian businesses in the global market.

Source 2.6 Australia has trade agreements with a range of countries around the globe.

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Emergence of global consumers

Globalisation enables higher incomes, and many parts of the world have a rapidly growing middle class who wish to buy goods and services that improve their quality of life. For example, by 2025 India's middle class will have grown from about 5 per cent of the population to more than 40 per cent, which will create the world's fifth-largest consumer market. The demand for consumer goods such as televisions and other household goods will be enormous.

Globalisation opens up new markets, and operations may need to change the features, design, quality or information for a good or service to suit these new markets. Products may need some changes to suit particular aspects of the target market in different countries. In other countries, the business may not need to alter its core product at all to suit the same target market. It may be possible to supply a standardised product that needs only a small change to suit the culture of the local market.

Owing to differences in language, religion, tastes and ethics, it is very important that a business planning to sell in a new market adequately researches that market to reduce the chances of the product failing. It is also important for operations to have the flexibility to modify products as required.

Different cultures

When relocating or expanding operations, a business will encounter differences in the way the business operations need to be organised and managed. It is advisable for global businesses to use local experts who can help prevent issues caused by cultural clashes and communication problems. For example, the international organising committee for mega-events must work with local government, which in turn must work with local contractors and builders to deliver a well-resourced, organised event such as the Olympic Games or the Commonwealth Games. The 2020 Japan Olympics were well planned using the *kaizen* 'continuous improvement' management approach to project scheduling, emphasising efficiency and quality control. This compares with the 2016 Brazil Olympics, which appeared so disorganised during the construction phase that no amount of money was able to ensure that venues were ready for competition. The Indian Government's preparation for the 2010 Commonwealth Games equally frustrated the Commonwealth Games Organising Committee, owing to the last-minute approach to organising this mega-event.

The Indian way of doing things is termed 'Jugaad-in-time'. In the **Jugaad** approach, planning, operations strategy and strict project management are considered wasteful. Scheduling problems are overcome by adding more resources. Despite criticism, this approach can also be considered highly flexible, innovative and frugal.

Jugaad Originating in India, this term pertains to making use of what resources are available to complete a project imminently before it is due; a quick fix to a problem using whatever is available.

Review 2.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Outline two advantages of globalisation for the operations function of a business.
2. Outline the impact of an increasing value of the Australian dollar on an Australian business that imports parts to assemble into finished goods.
3. Explain why multinational businesses have a global web of operations.
4. Analyse the impact of free trade for Australian businesses.

Activity 2.2

1. Use the Austrade website to research a case study of an Australian business that sells in an overseas market. Many case studies are available at FTA Case Studies and Videos (https://cambridge.edu.au/redirect/9578). Outline and explain the business's achievement in the overseas market.

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2.2 Technology

Globalisation has spread technological developments worldwide. Wireless internet access, communications technologies and mobile phone applications have made it easier and cheaper to manage global businesses and international trade. With globalisation, businesses can access **technology** not available in their home country. Strategies to acquire technology include a joint venture or strategic alliance with another business, or simply purchasing businesses that have the desired technology. For example, Chinese car manufacturers such as SAIC, Dongfeng Motor Corporation and Beijing Automotive are keen to learn from European, American and Korean vehicle manufacturers. VW, General Motors and Hyundai have local partnerships with Chinese companies. In return for access to the rapidly expanding Chinese market, local producers have access to the latest technology and production techniques.

Technology The equipment, materials and knowledge that are available to help businesses perform certain functions or make products.

One of the major external influences on business operations is technological change. Technology refers to both equipment and knowledge, and it can improve the way a business performs functions or makes products. Technology can result in the development of new methods of production or new equipment that helps businesses perform functions more quickly and often at a lower cost. There is a heavy reliance on the operations manager to be aware of this technology and assess its application to the business. The business will weigh up the costs of the upgrade in technology against the expected benefits, such as increased sales.

New technology has drastically changed the operations of both manufacturing and service-based businesses. Despite the high initial cost of developing or acquiring new technology, the overall gains to productivity and quality are obvious. New technology can save time and reduce waste, making the business more efficient and therefore more profitable. A business can obtain a sustainable competitive advantage through the implementation of new technology.

When making a decision about technology, a business must take into account various factors, including:

- the speed of change taking place in that area of technology
- the technology that competitors are using
- the finances available to purchase technology
- how long it will take to introduce the technology (especially if all work needs to be stopped)
- whether staff will need to be retrained or possibly made redundant.

Managing change with respect to implementing new technology creates a challenge for management because they must also maintain effectiveness and efficiency in operations.

Business Bite

Intellectual property (IP) is a valuable asset that needs protection in global markets. IP includes patents, trademarks, copyright and designs. Unfortunately for the Australian iconic sheepskin UGG boot, the trademark 'UGG Australia' was acquired by an American firm, Deckers Outdoor Corporation, in 1995. International IP law prevents Australian companies from manufacturing and selling UGG boots into those 130 countries where Deckers owns the trademark. In 2019, a Sydney business owner, Eddie Oygur, founder of Australian Leather, lost his legal case against Deckers and was ordered to pay nearly $650 000 in damages after his business sold 12 pairs of UGG boots into the United States.

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Source 2.7 New technologies have rapidly transformed some of the work done at airports and have led to jobs being made redundant.

Source 2.8 Technology in different industries

Automotive technology example	Medical technology example
Computer numerically controlled (CNC) machines, such as robotic arms, manufacture, position and finish car parts. The robotic arm paints every piece of the car more evenly, puts the parts in the correct place every time and manufactures the entire car faster than human beings.	3D medical imaging technology uses multiple CT, ultrasound and MRI scans combined with software. These 3D images can be reviewed and manipulated by a doctor or specialist to more effectively diagnose disease and other problems without invasive surgery.

Robotics

Technology has progressed so far that in some instances employees have been replaced by machinery, such as robots.

Robotics refers to the development of robots, which are programmable machines that may have sensors that can detect changes in their environment. Initially built to complete repetitive tasks, many robots today have a degree of artificial intelligence (although this is not a necessary prerequisite for being classed as a robot). They are used where dangerous or hazardous work is required and they perform increasingly complicated tasks.

For a manufacturing business, robots can increase efficiency by working without breaks and performing tasks more precisely than human employees. Employees may become bored with repetitive work, resulting in a drop in the quality of the product. Robots do not suffer from boredom, need lunch breaks, take days off or require to be paid a wage. However, they do require a power source, maintenance and sometimes expensive repairs if there is any mechanical failure. The high cost of robotics often limits its availability to large businesses, such as car manufacturers.

Robotics The development of robots, which are machines that can be programmed to perform a variety of repetitive tasks.

Assembly-line robots became the norm in the car industry in Japan, North America and most of Europe in the 1980s, primarily for economic and cost/productivity reasons. In the 1990s, workers

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in manufacturing became increasingly assertive in demanding wage increases and better working conditions. In this context, the idea of automated production lines with robots became increasingly desirable. This practice is sometimes referred to as 'capital labour substitution'.

CAD and CAM

Computer-aided design (CAD) is computer technology that allows architects, engineers and designers to draw and adjust three-dimensional designs using a computer. The designs can be created based on the specifications or special conditions set by each client's requirements. Using email, the client can review the CAD from anywhere in the world, make comments on the designs and request alterations to them. Additionally, CAD allows designs to be looked at from various angles and provides a more effective visual presentation than a drawing on a sheet of paper. Three-dimensional images can be manipulated, allowing for greater product innovation.

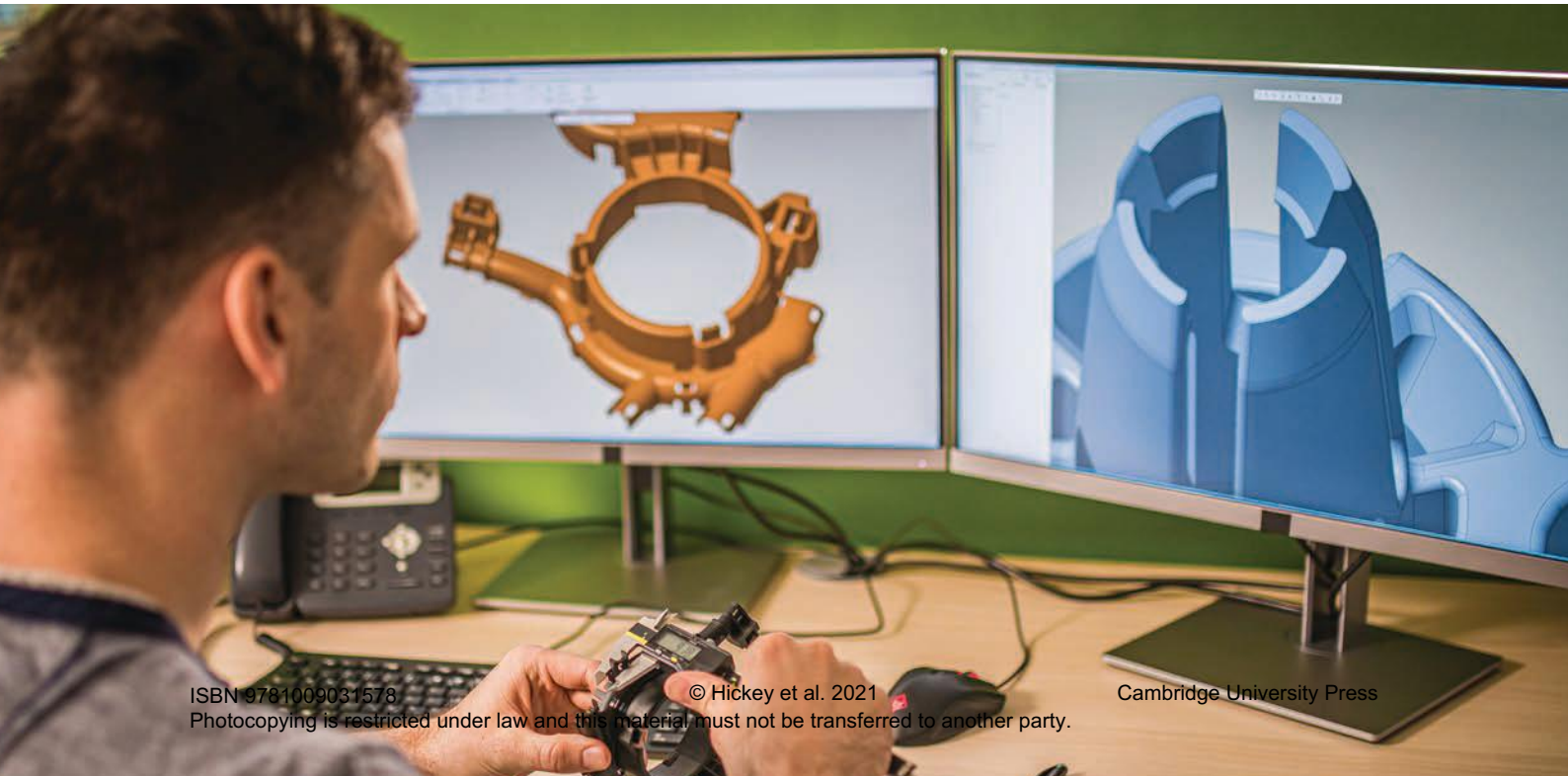
Computer-aided design (CAD) Computer technology that allows architects, engineers and designers to draw and adjust designs using a computer.

Computer-aided manufacture (CAM) Computer technology that directly links the design process to the manufacturing process using computers.

CAD can be linked directly to the manufacturing process through **computer-aided manufacture (CAM)**. With CAM software, the computer can be set to control large sections of production with greater efficiency, fewer errors and fewer staff. This process provides electronic links for exchanging data, which results in time saved and fewer mistakes. CAM software allows for much greater precision in the calculation of each input required in the production process and in calculation of the expected output. So if CAD and CAM are outsourced, subcontractors can receive precise, accurate details about component parts.

It is easy to imagine the use of technology in manufacturing; however, technology has also had a significant influence on service-based industries. E-commerce, databases, the internet and cloud computing can save both time and money. Staff need to be more multiskilled and IT-confident. Overall, the number of staff required in service-based organisations is decreasing. For example, one supermarket checkout operator can manage multiple self-service checkout machines as customers use the devices themselves to scan their groceries. The scanner can take a variety of payment methods, dispense change and even determine if an item has not been paid for. Staff change from operating to monitoring and correcting problems.

Technology, therefore, has a major impact on the human resource function of a business. Human resources must acquire staff with the appropriate skills and abilities and provide ongoing training to update their skills as technology changes. Other employees may be made redundant by new technology.



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Business Bite

3D-Seed SL has developed the world's first modular real-time recycling system for 3D printing. It is a desktop plastic shredder and 3D printer capable of directly recycling PET water bottles into new 3D printed parts. Plastic soft drink, water and other bottles can be fed straight into the system and transformed into inputs; for example, going from a water bottle to a 3D printed shot glass in 20 minutes. A demonstration of 3D-Seed's recycling 3D printer is available on its YouTube channel (https://cambridge.edu.au/redirect/9579). 3D-Seed was awarded a British Plastics Federation 'Highly Commended' certificate in 2019 (https://cambridge.edu.au/redirect/9580). 3D-Seed was originally a Spanish startup co-founded by Sydney engineer David Bassetti in 2014 to support the circular economy. The circular economy is an alternative to the 'take, make, consume and dispose' mindset, and moves beyond simply recycling. Waste can be transformed into raw materials, combining recycling, reuse, renewable energy and biomimicry. The company relocated to Sydney, Australia, in June 2020 after the COVID-19 pandemic hit Spain, and now offers design and manufacturing using all types of recycled post-consumer waste plastics, from furniture to milk crates, as well as 3D printed pieces. Recently, the company announced its own circular economy program for schools, where the students track their waste using smart bins, collect, clean and reprocess the waste, and make products for use in the school or for sale with their own new business.

Source 2.9 3D-Seed is working on an open-source 3D model for everyone to be capable of making their own masks.

In early 2020, while still in Spain, 3D-Seed SL developed a 3D printed mould for silicone casting a personal face mask. When the infection rate became overwhelming, the system was designed with a standard off-the-shelf mask and won an International Design Award (https://cambridge.edu.au/redirect/9581).

Review 2.2

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Outline two considerations when implementing new technology in a business.
2. Describe the impact of technology on the human resource function of a business.
3. Explain one risk of entering into a joint venture or strategic alliance with a foreign business.
4. Analyse the impact of technology on a business's ability to use a cost leadership strategy to obtain a competitive advantage.

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2.3 Quality expectations

A business that is customer-focused aims to produce goods and supply services that will satisfy the desires of its customers. Customers often have a pre-existing idea about the quality of a certain product or brand. They will have certain beliefs about:

- durability – how long the product lasts given a reasonable amount of use
- reliability – how long the product functions without needing maintenance or repairs
- fitness for purpose – how well the good or service actually matches all the claims of the advertising.

Digital quiz
Please see the Interactive Textbook to access digital activities.

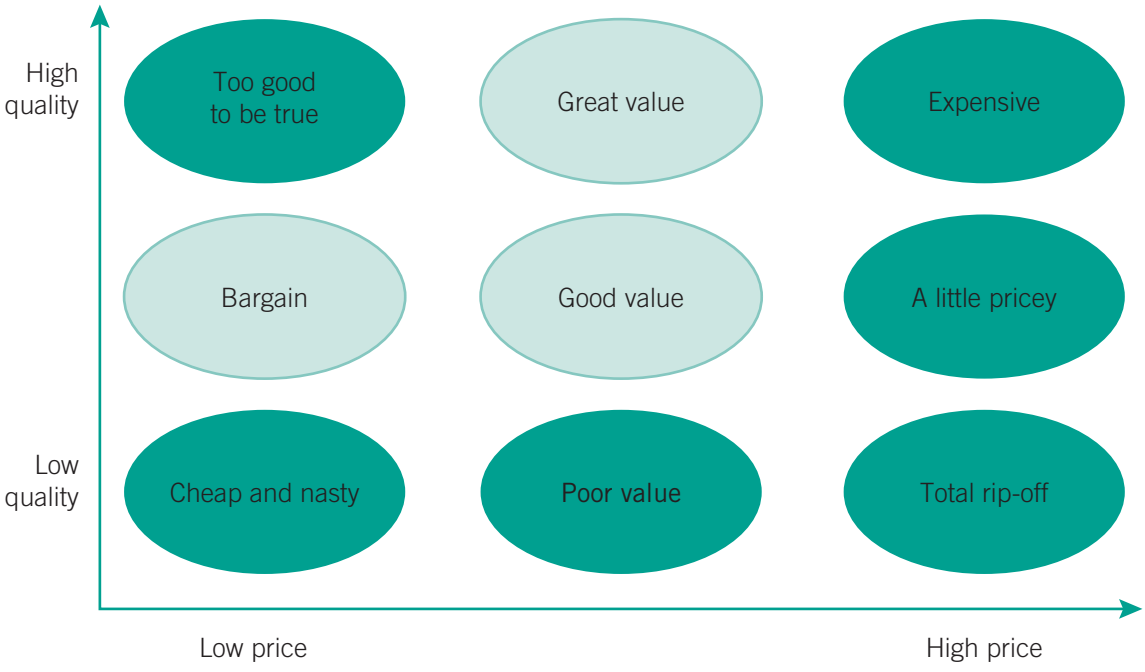
This quality expectation can be based simply on the reputation of the brand's products in general and the price paid for the product. Effective marketing fulfils the expectations of customers and, therefore, marketing relies on the operations function to produce a good with the features, design and quality that buyers expect. Operations does not necessarily have to make a high-quality product, just a product that matches customers' expectations. Sometimes the most popular products are not of the best quality (see Source 2.10).

Digital quiz
Please see the Interactive Textbook to access digital activities.

A business that falls short of customers' expectations will suffer long-term damage to its goodwill and reputation in the market. Therefore, operations must be organised to maximise customer satisfaction, and customers are a key influence on business operations.

2.4 Cost-based competition

If a business uses operational strategies to lower its costs, it can make its prices lower than those of its competitors. Sales and market share should increase as well as profit. This cost leadership strategy was described in Chapter 1. A cost leadership strategy works best when there is little difference in the products being offered by competitors, and so businesses get a competitive advantage by reducing the costs to produce and supply their products at a lower price. This influence may force a business to seek its own cost advantages by sourcing cheaper inputs, updating technology or outsourcing. Alternatively, if the business cannot compete on costs, then it may switch to a differentiation strategy. In a globalised marketplace, Australian businesses are increasingly influenced by overseas manufacturers that have a cost advantage. Australian businesses that cannot compete on costs must use an alternative strategy, such as product differentiation.



Source 2.10 How customers perceive quality and price

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2.5 Government policies

Government policies can encourage the operations function of a business to be more innovative and competitive. Economic growth will benefit if Australia can 'do more with less', increasing productivity and reducing the cost of producing exports.

The federal government has given much support to 'sunrise industries' and new technology so that businesses can develop new export products and earn income for the economy. A common way to support these innovative businesses is to provide a monetary benefit such as a financial grant or **tax concessions**. These financial benefits will give the business more funds to invest in leaner operations and new products. Changes in federal government have had major impacts on climate policy. The carbon tax was dropped when the 2014 Liberal–National Coalition government replaced this policy with its Direct Action Plan (DAP). However, in 2017 the DAP was replaced with the National Energy Guarantee, which intended to reduce greenhouse emissions to achieve Australia's commitments under the Paris Agreement. This policy was abandoned in 2018, and since that time subsidies, rather than taxation, have been used to boost renewable energy production in Australia. The Emissions Reduction Fund (ERF) is the main mechanism to reduce greenhouse gas emissions and is the centrepiece of the Commonwealth Government's climate change policy. All the government's climate policies are designed to support businesses to change and innovate their operations to reduce emissions, increase energy productivity and increase their use of renewable energy. Under the Paris Agreement, Australia now has the target to reduce greenhouse gas emissions to 26–28 per cent below 2005 levels by 2030.

Austrade is a government organisation that provides a range of assistance to Australian businesses wishing to export and expand into the global economy. As well as financial support and assistance for exporters, businesses can get specialist advice about establishing manufacturing overseas and an introduction to potential suppliers. Other government policies involve reducing the amount of protection certain industries receive from overseas businesses. The gradual removal of tariffs, quotas and other types of protection has forced Australian businesses to be more competitive by reducing operations costs. The reduction of protection in clothing manufacturing in the textiles, clothing and footwear industry has forced many businesses to relocate operations to countries where resources are cheaper.

Tax concession A reduction in the tax payable by businesses that undertake certain areas of research and development.

Source 2.11 Haval is known globally for its cost leadership in the car manufacturing industry.

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Review 2.3

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Briefly outline how consumers perceive quality.
2 Explain how operations can provide a cost advantage to businesses.
3 'Operations fulfils the quality expectations marketing creates.' Evaluate this statement.
4 Use the link https://cambridge.edu.au/redirect/9582 to read the article and answer the following questions.
   a What is planned obsolescence?
   b Describe the consequences of planned obsolescence in consumer electronic products.
   c Explain why businesses would incorporate planned obsolescence into their products.
   d Analyse the impact of a new government policy that requires businesses to make repairable products.

2.6 Legal regulation

The aim of government regulation of businesses is to ensure safety and fair business conduct. These regulations include those covering environmental and consumer protection, trade practices, work health and safety, and industrial relations. In Australia, over recent years, laws have undergone many amendments through parliament and changes in the **common law** judicial system. In many industries, some regulations have been removed to enable firms to become more efficient and to reduce the number of restrictions hampering competition. Legislation to ensure the safety of employees and consumers has been strengthened.

Common law Law that is derived from previous court decisions made by a judge.

There are numerous laws and regulatory requirements that affect operations (see Source 2.13). Many of the regulatory requirements exist at a local, state and federal level. It is the legal responsibility of the operations manager to be aware of all laws relevant to the operations function and to ensure that the business complies with them. There are serious financial consequences for failing to satisfy government regulations. In addition, negative publicity and media attention will damage brand value and reputation. This will potentially have longer-term impacts on sales and profits.

Business Bite

Products must be safe to use. Following an Australian Competition and Consumer Commission (ACCC) safety investigation, a compulsory recall of vehicles with Takata airbags was announced in 2018. This was a critical recall after there had been earlier voluntary recalls. The critical recall was for the airbag model that had a design defect that could result in the airbag inflating with too much explosive force so that sharp metal fragments shoot out, potentially injuring or killing occupants. It is the most significant compulsory recall in Australia's history, involving more than three million vehicles and affecting nearly every make of car available in Australia.

Continued →

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A government website (https://cambridge.edu.au/redirect/9583) was launched for owners to check if their vehicle was recalled.

Under Australian consumer protection law, the supplier was responsible for replacing the airbag. For car sales, this was the first person to supply a vehicle with a defective Takata airbag into Australia. In most cases, this will be the Australian office of the vehicle manufacturer, not the dealer. In addition, dealers were ordered not to sell vehicles with the defective Takata airbag in any circumstances after 31 December 2018.

The timeframe set by the ACCC was to complete all replacements by 31 December 2020. If an owner ignored multiple recall notices and failed to have the airbag replaced, their car would not be able to be registered after this date. The ABC's *The Checkout* has provided its perspective on YouTube at https://cambridge.edu.au/redirect/9584.

Source 2.12 Stephanie Erdman of Florida, United States, who was seriously injured by the airbag explosion in her Honda Civic during a traffic accident, testified during a Senate Committee hearing to examine defects in airbags manufactured by Takata and its recall process.

There are many federal and state laws, principally to ensure three objectives. First, the business operations must be safe. Second, the negative impact on the environment from business operations needs to be avoided or minimised. Third, if a business claims that the products it makes or supplies meet a particular standard, are safe to use and are of a certain quality, and that all relevant information is provided, then it must ensure that this claim is true.

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Source 2.13 The impact of legislation

Area of regulation	Legislation	Legal obligations and implications
Workplace safety	*Work Health and Safety Act 2011* (Cth)	Employers must diligently prepare an occupational health and safety assessment of the business to ensure that employees are provided with a work environment that is both physically and mentally safe. This involves: • a safe worksite • safe machinery and materials • safe systems of work • information, training and supervision to ensure safety • a suitable working environment.
Hazardous materials	*Occupational Health and Safety Act 1991* (Cth) *Dangerous Goods (Road and Rail Transport) Act 2008* (NSW)	Training, warning signs and safety precautions to prevent injury. Businesses are encouraged to eliminate the use of hazardous products if possible. Safe measures to transport hazardous and dangerous goods.
Environmental protection	*Environment Protection and Biodiversity Conservation Act 1999* (Cth)	Operations must ensure hazardous waste, fuels and chemicals do not enter the environment.
Climate change	Carbon Neutral Program	This policy encourages businesses to reduce greenhouse gas emissions by supplying carbon neutral goods and services. Businesses can earn carbon certificates.
Australian standards for quality, environmental impacts, safety and information	*Competition and Consumer Act 2010* (Cth) (formerly the *Trade Practices Act 1974* [Cth]) *Fair Trading Act 1987* (NSW)	• Quality – products must perform the task they are intended to perform. • Environmental – goods need to comply with environmental standards before they can be sold. Standards set out an energy rating and labelling system to inform consumers. • Safety – goods are required to comply with performance standards, composition, contents, method of manufacture, design, construction, finish and packaging rules. • Information – labels must include all relevant information, such as country of manufacture and ingredients.

Review 2.4

Comprehension and discussion

Answer these questions on paper or in the Interactive Textbook.

1 Outline the legal obligations for workplace safety an employer has towards it employees.
2 Describe the impact of the *Competition and Consumer Act 2010* (Cth) on the operations of a business making children's toys.
3 Use the link https://cambridge.edu.au/redirect/9585 to read the article and answer the following questions.
   a Outline the responsibility of employers for occupational health and safety under the model *Work Health and Safety Act 2011* (Cth).

Continued →

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b Explain what is meant by the term 'reasonably practicable' in the wording of health and safety laws.
c Can an employer claim that they were not aware of a risk and therefore not take action? Justify your response.
d Employees have a legal right to refuse work if they fear for their health and safety. Discuss.

2.7 Environmental sustainability

Environmental sustainability refers to the development and use of methods of production that allow resources to be used by producers today without limiting the ability of future generations to satisfy their needs and wants. The natural environment must be protected from resource depletion and pollution. More than ever, managers have a responsibility to protect the natural environment, which includes making sure that their production methods use resources in a sustainable manner.

Emphasis needs to be placed on the development of technology that minimises damage to the environment. Therefore, the impacts of resource depletion, the site of resource removal, pollution caused by machinery (especially in manufacturing), and the removal and storage of waste need to be taken into account when making operations decisions. Consumers need to be aware of the cost and disposal of excessive packaging and be given clear instructions on the proper use of products and, in some instances, on how to dispose of products responsibly.

As more businesses include the cost to the environment, such as carbon emissions, in their prices, this will help to increase awareness of environmental impacts. Business managers should realise that the advantages generated by the practices outlined in this section are broader than the environmental benefits. Society will have a positive attitude towards businesses that are environmentally friendly and act as good corporate citizens. Society's support for these businesses will be shown through increased sales and customer loyalty.

Activity 2.3
Research

Research a sustainability report published by an Australian company listed on the Australian Securities Exchange. Assess three environmental sustainability achievements reported by the business.

Digital quiz
Please see the Interactive Textbook to access digital activities.

2.8 Corporate social responsibility

Corporate social responsibility (CSR) has been increasing in importance as a genuine goal of business. It is an extension of the triple bottom line (TBL) concept, in which a business's performance is evaluated according to its financial, social and environmental criteria. Other CSR issues concern:

- equity and justice
- human rights
- corruption and payment of bribes
- corporate transparency and honesty
- labour standards, particularly in less-developed countries
- employee wellbeing.

CSR is the duty of care a business has towards its stakeholders other than shareholders. As the concept is still evolving, there is not yet a single globally accepted definition. The World Business Council for Sustainable Development defines CSR as:

> The commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve the quality of their life.

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CSR is typically weaker in developing countries as a result of fewer regulations and government support for multinational corporations that can stimulate economic growth. Even though momentum for CSR is building, there is still debate about the issue.

Many internal stakeholders would argue that the core purpose of a business is to maximise shareholder value and returns to its owners while obeying the laws of the country it is operating in. The other side of the argument is that a business's long-term success and profitability are determined by how well it considers the interests of employees, consumers and the community. Discussion about CSR at a government level has been a result of several high-profile examples, such as the building company James Hardie Ltd, and has led to new laws enforcing CSR behaviour. James Hardie Ltd manufactured building products using asbestos and had to set up the Medical Research and Compensation Foundation (MRCF) as the company was found responsible for exposing employees to asbestos fibres, which can cause malignant lung cancer, asbestosis and mesothelioma.

At present in Australia, company law and common law cannot compel company directors to consider stakeholders other than shareholders when making decisions. However, there are laws covering working conditions, consumer protection and environmental protection. In the future, company directors and owners of businesses may be found criminally responsible for the consequences of poor decisions that affect other stakeholders.

Business Bite

Adidas is committed to reducing plastic in the world's oceans and has been collaborating for a number of years with Parley. Parley (https://cambridge.edu.au/redirect/9586) is an organisation whose focus is to reduce plastic in the oceans by creating a collaboration space for everyone from filmmakers to product designers to scientists. Adidas has been in partnership with Parley since 2015 to phase out single-use plastics and microbeads used as inputs. Adidas has developed and launched entire product lines using recycled and reclaimed marine plastic waste. The UltraBOOST Uncaged Parley shoe uses recycled plastic in its shoelaces, heel linings, and sock liner covers. Limited-edition Parley jerseys and Parley swimwear use recycled fishing nets up-cycled into yarn fibre. The Adidas X Parley collaboration is part of a longer-term CSR strategy by Adidas to eliminate new plastic from its supply chain.

Activity 2.4
Discussion

1 Businesses have a responsibility to their shareholders and owners before other stakeholders. Discuss.
2 Corporate social responsibility practices are marketing strategies. Discuss.

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The difference between legal compliance and ethical responsibility

Ethics may be thought of as doing the 'right thing'. It is more than merely complying with the law and pleasing the owners of the business with higher profits. Ethical behaviour involves making decisions that are not only legally correct but also, in a sense, morally correct and which meet the standards of behaviour that society expects.

'Business practice' and 'ethical behaviour' could once have been considered mutually exclusive terms. However, the business community is now recognising the need to act in a responsible and transparent manner. Business ethics are the principles a business will follow to be a good corporate citizen. In order to show their commitment to ethical behaviour, many industries and businesses will develop, implement and publish a code of conduct. This code will cover issues such as:

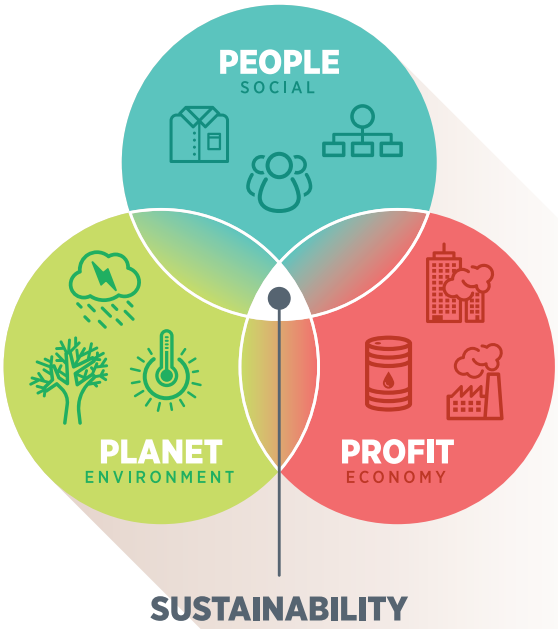
- supporting charities and local community organisations
- consulting the community prior to implementing a significant change to the business
- promoting human and civil rights, both in Australia and overseas.

For operations, a code of conduct will be concerned with:

- minimising harm to the environment
- reducing waste, recycling and reusing
- producing value-for-money, quality products
- improving customer service.

Many industries have recently developed a code of conduct to improve the standard of behaviour by all businesses in the industry. A code of conduct is not legally enforceable but is a voluntary set of rules and guidelines to guide the behaviour of businesses or organisations in a way that benefits key stakeholders and customers.

For example, fitness centres and gyms have changed their operations to allow customers to avoid being locked into long-term contracts and to pay their membership each month they use the centre. The language of contracts has been changed to plain English so that customers understand what they are signing. In terms of marketing, many centres no longer use high-pressure personal selling techniques to sign up new customers. These changes represent a more ethical and transparent way of doing business.



Source 2.14 Modern businesses aim to have a balance between people, planet and profit.

Ethical Spotlight 2.2

How much responsibility for a community should a business be expected to carry?

Environmental sustainability and social responsibility

The concept of environmental sustainability has been discussed earlier in this chapter. It is related to the idea of **social responsibility**. By pursuing environmentally sustainable goals, a business will be contributing to a better quality of life for society. A business that behaves in a socially responsible manner is one that tries to improve the quality of life of both internal and external stakeholders. This type of behaviour is being measured as a specific outcome of business.

Social responsibility Involves taking actions or making decisions that are morally and ethically correct and are in the best interests of the community.

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Interbrand, a brand consultancy firm, publishes an annual list of the top 100 global brands, based on financial performance, influence on consumer choice and strength. Interbrand also analyses how well each company in its top 100 ranks against consumer perceptions of environmental practice, to identify the Best Global Green Brands.

Businesses today are increasingly aware of the impact their decisions have on society and the environment. People in the community are more aware of the activities of businesses because they are shareholders. There is also greater scrutiny by the media, organisations such as the not-for-profit Australian Consumers' Association (which publishes *CHOICE* magazine) and government institutions such as the Australian Competition and Consumer Commission and the Australian Securities and Investments Commission. There is an expectation by society that businesses must consider and value achievements other than increases in profit growth and market share. When making decisions, managers need to take into account the consequences of their actions on all stakeholders. It is not sufficient to simply obey the relevant laws; managers are also expected to make decisions that exhibit social responsibility.

The increased speed of change has resulted in society pressuring businesses to accept additional responsibility that laws have yet to cover. Managers need to consider whether their decisions will be good for the community or whether they will provide their business with a cost advantage at the expense of the community. Examples of socially responsible actions include:

- Coca-Cola Amatil has continued its support of female entrepreneurs, donations to nutrition and physical activity programs as well as allocating the equivalent of 1 per cent of its earnings to community investment programs.
- Cue, the fashion brand, is committed to manufacturing almost all of its products in Australia and is the largest local manufacturer of fashion. Cue has been accredited with Ethical Clothing Australia (ECA) since 2009. ECA ensures that Cue's workers are paid appropriately, receive all their legal minimum entitlements and work in safe conditions.
- Oil companies in Australia, such as BP and Caltex, have invested over $2 billion into producing biofuels such as ethanol (E10) and biodiesel to reduce pollution and greenhouse gas emissions.

Some businesses publicise their responsible and sustainable activities in their marketing strategies. This is more commonly known as green marketing. A good public image will encourage long-term profitability. Green marketing must be supported with environmentally sustainable policies and practices.

In addition to the value added to a brand from CSR strategies, firms may find both short-term cost advantages and long-term financial benefits. For example, a business that has installed renewable energy systems may find that it has a cost advantage over those businesses that rely on fossil fuels.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Chapter summary

Globalisation is integration and interdependence of the economies of different countries through freer trade, technology, innovation, deregulation and growth of global businesses, thus creating a global economy.

Globalisation influences business operations as a result of different currencies, trade agreements, global consumers, technology and differences in cultures. There is the opportunity to reduce operations costs and expand.

Operations must be organised to maximise customer satisfaction by producing products that match the expectations of consumers.

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Government policies encourage businesses in Australia to be more competitive through cost-efficient operations, environmentally sustainable practices and innovation.

Legal regulations aim to ensure that business operations are safe, that the negative impact on the environment from business operations is avoided or minimised and, finally, that products live up to the quality and safety standards the business claims.

Business ethics are the rules and principles a business follows in order to be a good corporate citizen.

Socially responsible business decisions include promoting equity, justice and human rights, not engaging in corruption or the payment of bribes, being open and consultative, and improving living standards.

Consumers, the media, organisations and governments are increasingly holding businesses more accountable for the social and environmental consequences of their actions.

End-of-chapter tasks

Chapter revision task

Rewrite the following paragraph using the words listed in the box to fill in the blanks.

operate	cultural	competitive	information	innovations
relocating	risk	costs	increasing	agreements

Businesses _____ in a dynamic and highly _____ global environment. This means that gaining a competitive edge requires reducing operational _____ so that the business can lower prices below those of its rivals. Often the opportunity arises to access lower-cost inputs and produce more cheaply by _____ to a country where inputs are cheaper, which can lower operations costs. Globalisation also offers a global market for a business to distribute its products to, which will present more challenges to operations. Operations must have the correct market _____ in order to differentiate products to match the desires of consumers in different countries. There will be other influences on the operations function when operating in the global environment. Payment of inputs will have to be financially managed to reduce the _____ of an appreciating AUD _____ input costs. Trade agreements of which Australia is a member will open up new opportunities to source inputs and distribute final products. However, other trade _____ will exclude Australia from the potential benefits of globalisation. Australian businesses can also access technological _____ in operations through joint ventures or simply taking over other firms. Finally, when operating in different countries, both human resource and the operations functions will need to be aware of _____ influences that affect the way people work, make decisions and organise operations.

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Multiple-choice questions

1 For an Australian exporter, which of the following would be classified as an opportunity in a SWOT analysis?

A Competition from global businesses
B Appreciation of the Australian dollar
C Locating close to raw materials in low-cost countries
D Emergence of global consumers

2 What aspects of operations are most impacted by globalisation?

A Input costs and products
B Labour and finance
C Governments of other countries and legal regulation
D Input costs and human resources

3 An overseas business has made its own version of an Australian company's technological innovation. Which global influence on the Australian company is this?

A Legal
B Financial
C Cultural
D Technology

4 Which stakeholder is most likely to consider the environmentally sustainable manufacturing practices of a business when using its products?

A Australian Taxation Office
B Customers
C Competitors
D Owners

5 Which statement best illustrates the difference between CAD and CAM?

A CAM uses robotics and CAD uses computers.
B CAD uses robotics and CAM uses computers.
C CAM occurs before CAD.
D CAM and CAD are interdependent processes.

6 Which of the following influences exert the greatest pressure on businesses to act in a socially responsible manner?

A Government
B Society
C External stakeholders
D Shareholders

7 Which legislation forces businesses to provide safe working conditions in Australia?

A *Anti-Discrimination Act 1977* (NSW)
B *Workers Compensation Act 1987* (NSW)
C *Dangerous Goods (Road and Rail Transport) Act 2008* (NSW)
D *Work Health and Safety Act 2011* (Cth)

8 Which of these statements does legal compliance refer to?

A The operations manager must be fully informed of all relevant laws affecting the business.
B The operations manager must regularly report to government on how the business is obeying relevant laws.
C An operations manager must ensure that policies and procedures are implemented at the business to ensure laws are obeyed.
D An operations manager must pay above relevant minimum wages and offer flexible working conditions for employees.

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9 What term is used to describe two firms that share resources to expand globally?

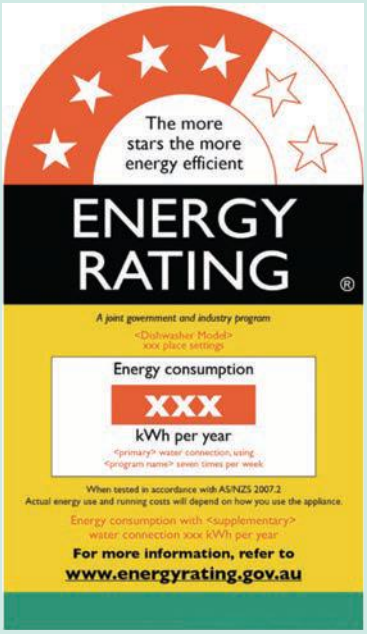
A Global web
B Joint venture
C Supply chain consolidation
D Trade agreement

10 What are the expectations consumers have about operations?

A That businesses produce a product that represents good value for money
B That businesses produce products in Australia to provide employment
C That businesses produce goods that comply with government consumer laws
D That businesses produce goods for the lowest possible price

Short-answer questions

1 Identify the influence on operations indicated by the following image.



2 Briefly explain how globalisation has made it possible for an Australian business to access new technology and innovation to improve operations.

3 Explain one risk to a business with a global web of operations. Refer to an example in your answer.

4 Analyse how quality expectations influence business operations.

Extended-response question

Businesses must act in a socially responsible and ethical manner because current legislation is inadequate. Discuss or debate as a class.

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3 Operations processes

Chapter objectives

In this chapter, students will:

- identify the activities involved in the transformation of inputs and outputs
- analyse the influences on the transformation process
- investigate the transformation process
- explain the role of technology in operations processes.

Key terms

- batch production
- component
- critical path analysis (CPA)
- flow production
- Gantt chart
- job production
- process technology
- task analysis
- task design
- value add

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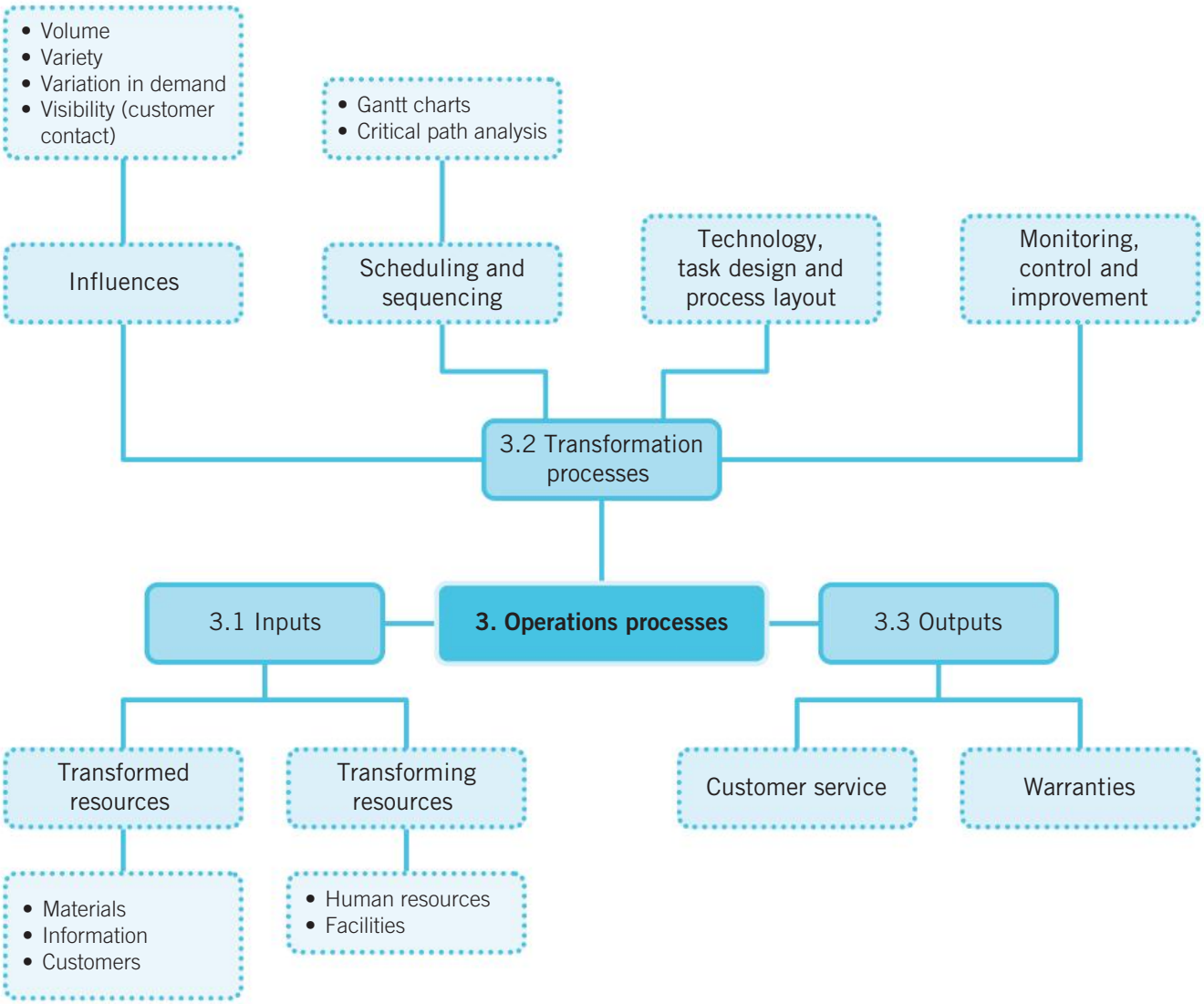
3.0 Introduction



Source 3.1 Operations processes concept map

Operations processes are the activities involved in the transformation of inputs into outputs. These may also be referred to as the production system or operations system. Each activity adds value so that the output has a greater value than the cost of inputs. The outputs will be sold for a profit.

Key questions that must be answered are:

- What production activities are required?
- What will be the sequence of the activities?
- How often will the process need to be changed or adjusted?
- What technology will be used?

The operations manager has a role in every part of the operations process. Their goals are to produce goods and provide services that are right the first time, to cut costs by eliminating delays and improving delivery times, produce in a dependable and flexible manner and, finally, control input costs. When assessing the performance of the operations function, the manager will determine how effectively the business makes and assembles raw materials and **components** into finished goods and services; how quickly it distributes to wholesalers, retailers and customers; and the quality of after-sales customer service.

Component A part or piece that is assembled with other components to create a finished good.

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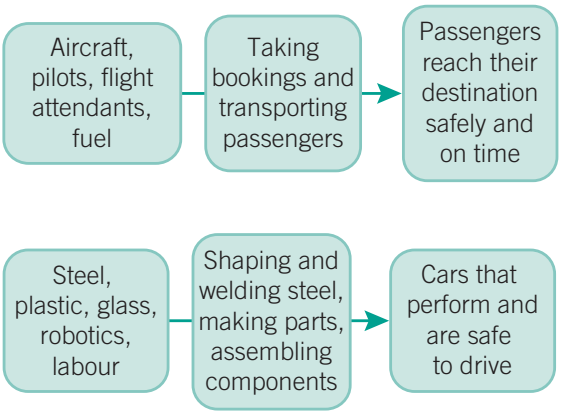

Source 3.2 Transforming inputs into outputs – operations for different products: an airline and an automotive factory

Digital quiz
Please see the Interactive Textbook to access digital activities.

3.1 Inputs

The inputs into operations are the physical raw materials and components used to make goods as well as the skills, creativity and knowledge required to provide services. Inputs are more complex and have links with the other key business functions: marketing, finance and human resources. Inputs may be classified as materials, people or physical resources, and are further categorised as transformed or transforming resources.

Source 3.3 Types of inputs

Materials	People	Physical
Raw materials	Labour (physical and mental)	Factory and office building
Parts and components	Managers	Land
Power and energy	Engineers	Machines and tools
Supplies	Maintenance	Office equipment
Water	Technicians	Computers

There are also intangible inputs of time and money. A business will need enough time to finish operations before a deadline and enough finance to purchase inputs and pay for the operations processes.

When inputs are transformed, they are converted into goods and services, which are known as the outputs. For example, for a music festival, the inputs are electrical power, lighting technicians, set designers, musicians, sound engineers, the physical land and computer equipment, and the outputs are entertained fans.

Source 3.4 Inputs at a music festival include electrical power, set designers and the physical equipment.

Some inputs are transformed resources and others are transforming resources; that is, the transforming resources are responsible for changing the transformed resources.

Transformed resources

These are the inputs that are changed and converted into something else, such as components used by other businesses or finished goods and services. Businesses use a combination of materials, information and customers. However, depending on the nature of the industry or type of business, one of these resources will be more important. For service-based businesses such as solicitors, doctors and financial advisers, information will be processed to produce a 'product' unique to the specific needs of the customer. Therefore, customers and clients will be the most important resource.

Manufacturers will focus on materials as their most important resource. Businesses involved

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in transporting customers, such as airlines, will probably have equal parts of these three inputs. Materials in the form of aviation fuel will be a significant expense, and information about flights, destinations, bookings and maintenance will also be used.

Business Bite

The most important physical input for Lego is plastic. Plastic is a synthetic organic polymer consisting of hydrogen, carbon, nitrogen, chlorine, and sulphur sourced from oil, coal and natural gas. The original polymer used to make Lego bricks, a cellulose acetate, had a tendency to fade in colour, so it was changed in 1963 to a stronger and more resistant acrylonitrile butadiene styrene (ABS). Raw ABS has Macrolex dyes added to create colour and is transformed into plastic granules approximately 2–4.5 millimetres in size, which is how plastic inputs arrive at the Lego factory. These granules are melted and transformed into Lego shapes. The transforming inputs include thermo moulding injection equipment, robots and conveyor belts. Human inputs include designers, artists and highly skilled maintenance staff. The output is approximately 15 billion Lego bricks and over 300 million tyres a year. However, making Lego from oil-based plastic has a significant environmental impact. So the company has been researching more sustainable raw materials. In the future, the Lego green leaves, bushes and trees will be made from polyethylene derived from sustainable sugar cane. However, this polyethylene is not strong or durable enough to replace ABS, and a suitable substitute for ABS is yet to be found.

Materials

Materials are the raw ingredients, components, parts and supplies used in operations. Materials may be referred to as inventory. Supplies are different from raw materials because they help in producing the output and are not a component of the final good or service. For example, in a real estate office supplies would include stationery, printer cartridges and the fuel used in the cars of sales representatives.

Materials are constantly flowing in and out of the business and are not kept for longer than 12 months. Some operations do not use up materials but change their location, as in a courier business or transport company. Other businesses organise a change in the possession of the materials – retailers do this.

Information

Business managers must know information relevant to their operations. Information is stored in files, in computer programs and in databases. This information is used to make plans, execute operations and keep control over materials inputs. Examples of information include the knowledge to operate equipment, work schedules such as critical path analysis diagrams, designs, customer orders, engineering plans and quality analysis reports.

Source 3.5 Business managers must understand the key information relevant to their operations. In some workplaces, this information is presented in the form of analysis reports.

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Information will come from analysis of the performance of the operations system. As a form of feedback, changes to operations, after mistakes or failure to achieve performance objectives, will also be an input into future operations. Information is an important input for information-processing businesses such as accountants or banks. The information is transformed – in the case of accountants and banks, for example, financial information is analysed and then changed into a new form such as a tax return or investment advice.

Customers

Customers can be changed in different ways. When they consume goods and services, they are transformed. They transform from an unsatisfied state to being satisfied. Doctors and hairdressers can transform the way customers feel and look. Airlines and travel companies change the location of their customers. When customers are entertained by theatres and movies, or stay in a hotel or resort, value has been added to their quality of life. Customers are also an input because it is their needs and desires that 'drive' the operations of a business. They provide information to the business about what goods and services will satisfy them. Businesses can no longer merely produce what they think customers want and expect to maintain a competitive advantage.

Therefore, this area of operations is closely connected to the marketing function.

Transforming resources

These are the resources that remain in the business and are applied to the inputs to change them to add value. They are not used up in the operations process.

Human resources

Many businesses recognise that people are their greatest asset. This is because the skills, knowledge, capabilities and labour of people are applied to materials to convert them into goods and services. There is a strong relationship with the human resource function, which provides the business with suitably qualified, skilled and experienced employees. Human resources will need to provide training as required.

Facilities

Facilities are the buildings, land, equipment and technology that the business uses in operations. Facilities remain in the business after materials have been used up. Machinery and equipment will be used to physically change the shape and features of materials. Other facilities are concerned with storing and moving materials and partly finished goods to warehouses. Technology is an essential element, as it can enable a business to use its transformed resources in a more efficient and effective way.

Source 3.6 Employees can be a business's greatest asset.

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Source 3.7 Examples of transforming resources in different industries

Transforming resources	School	Airline	Soft drink manufacturer
Human resources	Teachers	Pilots	Machinery operators
	Cleaning staff	Maintenance engineers	Chemists and food technology scientists
	Maintenance staff	Flight attendants	Forklift operators
	Parent volunteers	Cleaning staff	Engineers
	Administration staff	Baggage handlers	Quality control inspectors
	IT support	Aircraft refuellers	Security staff
	Drivers	Check-in staff	
Facilities	Buildings	Aircraft	Mixing vats
	Playing ovals	Hangars	Warehouses
	Library	Terminals	Labelling machines
	IT equipment and computing lab	Computerised booking system	Packing machinery
	Classrooms	Lounges	Conveyor belts

Activity 3.1
Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. State one transforming and one transformed resource for a takeaway fast-food meal.
2. Outline the difference between transforming and transformed resources.
3. Explain how the marketing function can provide inputs for operations.
4. Despite technological innovation in operations, there will always be a need for human resource inputs. Discuss.

Digital quiz
Please see the Interactive Textbook to access digital activities.

3.2 Transformation processes

Every business must consider how it will produce goods and supply services. The transformation processes are those activities that determine how value will be added through the combination of inputs.

These processes can add value in four ways:

1. physical altering of the physical inputs or the changes that happen to people when they use a service
2. transportation of goods or services, such as delivering to a more convenient location for consumers
3. protection and safety (for example, a bank keeps savings secure)
4. information, by providing customers with a better understanding of the features of the product and how it operates.

Consider how value is added through the transformation process in a bike shop. A local bike shop offers bikes for sale and carries a range of brands and types. Sales staff can explain the difference between different styles of bike, brands and quality, matching a customer to what best suits their purpose. For a particular customer who wants a more specialised bike for racing, the shop can **value add** in different ways. First, the owner can source

Value add Occurs when an operations process combines inputs with labour and facilities so that the value of the output is increased, and is greater than the cost of its individual inputs.

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a quality carbon fibre frame from a distributor and a range of components such as wheels, gears and cranks. The owner can employ a bike mechanic to build the bike, using the different components to create a value-for-money road racer for under $2000, which was the customer's budget. By sourcing and bringing all the components together at the local bike store, the shop adds value from transport. As the customer cannot afford to purchase the bike all at once, the shop keeps the bike securely in a locked room until final payment is made. Finally, when the customer pays for and picks up the new bike, the owner will take time to carefully explain the value, performance and features of each component used to create this unique product, thereby adding further value.

Producing a product can be done in a range of different ways. The operations manager must select the optimal process, considering the following factors:

- available capacity of the facility
- available knowledge and skills of employees
- type of production, whether it be job, batch or flow production
- layout of plant and equipment
- work health and safety
- production costs
- maintenance requirements.

The transformation process therefore needs to be designed, planned and controlled to make this process efficient and effective.

Influences – volume, variety, variation and visibility

There are four dimensions of operations – volume, variety, variation and visibility to customers – which are referred to as the four Vs. For different types of businesses, one of the four Vs will be the most important influence on the type of production used by the business. There are three types of production: job production, batch production and flow production.

Job production Producing a single unique item.

Batch production Producing a small number of the same item.

Flow production Producing a large number of items at the same time.

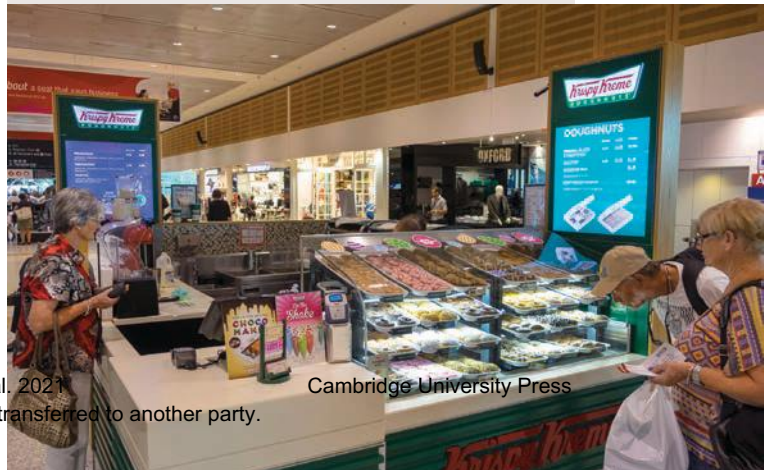
Job production, also known as jobbing, suits those products and services that require much higher quality and customisation than the standard product. Outputs are made on demand to suit what the customer requests. It is a highly flexible system but with a low output. There tends to be less capital and more emphasis on high labour content and skill. As a result, job production is much more time-consuming because there is greater consultation between the business and the customer. At the extreme end are projects such as building a unique architecturally designed home as a one-off job. In this type of project, costs per unit will be quite high.

Batch production is similar to jobbing, except products are made in groups or batches. A good example is a bakery that makes a number of slightly different pastries, using the same process and produced in batches of 50 to 200. There is emphasis on quality at an affordable price. Batch production requires careful planning so the production can be switched between products. Inputs will need to be changed and machinery recalibrated. However, the advantages of batch production are that it can produce different varieties of a good and deal with unexpected increases in demand.

Flow production (or line production) involves a continuous flow of inputs and outputs through the operations and is often associated with assembly lines. Products tend to have little variation; therefore, there is a high-volume output of a standardised product. Labour will be used to supervise equipment. Fuel refineries use a continuous flow process in which it is extremely difficult to halt production. Costs per unit tend to be low, owing to the high level of automation and economies of scale.

A business that must be a high-volume producer, such as a mining company or car assembly factory, will have to use flow production. A business that must produce a variety of models

Source 3.8 Bakeries produce different pastries using the same process in large batches.



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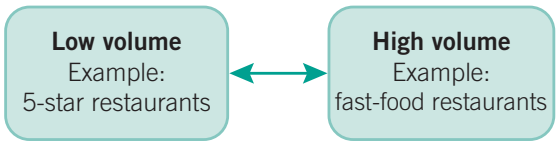
with different features requiring considerable skill will use batch production and even jobbing. Batch production will suit a business that must satisfy variations in demand. As demand for a particular good increases, the business can simply add more batches of the same product and delete batches of products not in demand.

Volume

Volume is the actual number of products or services produced by the operation. A business using flow production will produce a high volume with a high degree of process repetition. The number of items produced will be in the hundreds or thousands. The implication for operations when volume has the strongest influence is that there will be a large amount of capital, facilities, technology and materials used and much less labour. Assembly lines using conveyor belts will be common and will be organised in a fixed sequence of activities.

Low-volume operations, producing only a small number of items, will use much less equipment with the emphasis on multiskilled labour and may be involved in a 'craft'-type industry such as wedding dress design. A business that has low costs as its objective will use a high-volume operation, while a business that chooses product differentiation and flexibility will use a low-volume operation.

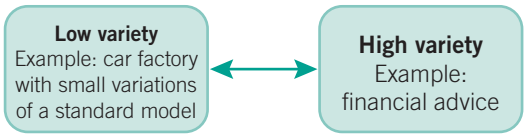


Source 3.9 Volume of production can differ significantly between different types of businesses within a particular industry.

Variety

Variety refers to the number of different models and variations offered by a business in its products or services. If the business has customers with different needs, goods and services will have to be modified or a wide variety of models and options will need to be provided. The business will probably rely on using sophisticated technology so that it can change production from one product to another without too much disruption to the operations process. Low-variety operations are routine in producing a high volume of a standardised product at a low cost.

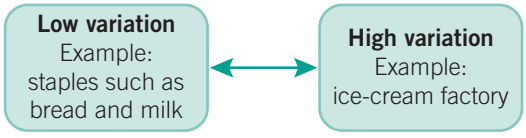
Therefore, the influence on the operations process will be similar to the influence of volume. A business producing a high-volume product with low variety will be capital-intensive, with assembly lines and a focus on producing at the lowest costs per unit possible.



Source 3.10 The variety of products and services offered by a business will depend on the different needs of its customer base.

Variation in demand

Operations will be strongly influenced by variations in demand over time. Variation can change according to time of day, season, public holidays and time of year. Where there is a steady, predictable level of demand with little variation, operations will be similar to those that produce low variety and high volume. That is, operations are routine, with low unit costs and using more capital than labour. When there is volatility in the pattern of demand, operations will need to be highly flexible. The operations manager will need to anticipate and plan for changes in demand and have a high level of contact with the market. Technology will be used so that the business can respond quickly to changes in demand.



Source 3.11 Variation in levels of demand for a product or service will influence a business's operations.

Visibility

Operations will also be influenced by the degree to which customers can see the operations in action. Service-based businesses will have a high level of visibility, while customers will rarely see the operations process of a manufacturing business.

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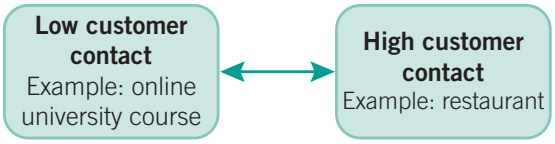
The implication for operations of a highly visible operations process is that the quality of labour will be significant. Operations will need to have well-trained, highly skilled, adaptable staff who are able to handle the individual needs of customers. A close relationship with the human resource function will be essential. Speed of operation will also be important, as customers usually have a much lower tolerance for waiting. So short lead times between customer ordering and delivery will be needed; otherwise, the customer may change to a competitor.



Source 3.12 Physical retail outlets have a higher level of customer visibility than online operations.

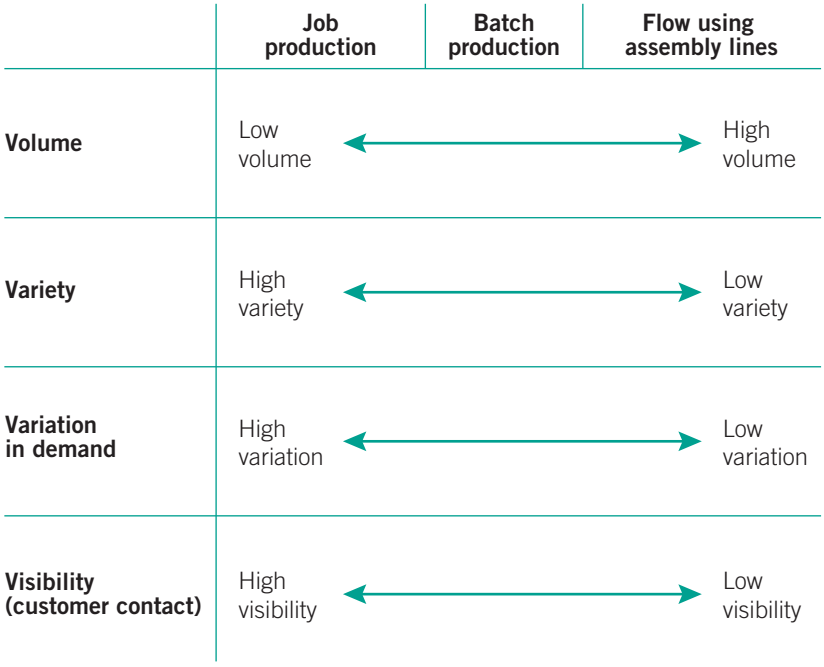
Many businesses may have a mixture of operations with high visibility for some aspects and low visibility for others. For example, the operations by bank tellers will be highly visible, while back office operations such as processing credit card transactions and managing loan contracts will not be seen. Further, this low visibility has allowed many banks to offshore these processes to countries such as India to reduce operating costs.

A business can change from having a high-visibility operation to having a low-visibility one. For example, a retailer may decide to close their physical shop and move to only selling products online. The changing nature of how customers shop means that a high level of personal customer contact is no longer always necessary to make the sale.

Influence of the four Vs

Of the four Vs, the most significant influences on the operations process will be volume and variety. A business that chooses to produce a high volume will be limited in its flexibility to produce a large variety or respond quickly to a change in demand. A business that is strongly influenced by changes in consumer preferences will tend to produce a higher variety of goods and, unless the business has very sophisticated technology, will produce in lower volumes.

The four Vs will also be influenced by the product life cycle. During the establishment phase, there will be a slow growth in demand and volume, with a higher level of customisation or changes in design. A business can expect demand to increase dramatically once it has passed through the establishment phase and entered the growth stage, increasing the volume the business must produce. Once in the maturity phase, the business will have low variations in



Source 3.13 Influence of the four Vs on operations

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demand and may offer more variety to attract different target markets. As the business enters the decline phase, demand and volume will fall and some variations on the standard product will be deleted from production.

Therefore, businesses need to be flexible in their capacity, and have access to resources and the use of technology to meet these changes in the four Vs over the life cycle of the business.

Task analysis The breakdown of exactly how the manufacture of a good, or activities to provide a service is to be accomplished.

Business Bite

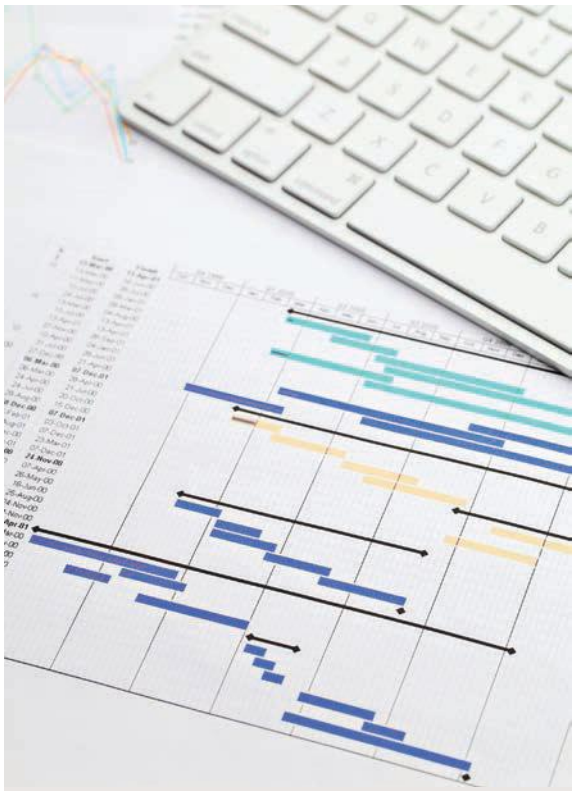
McDonald's, originally established in the 1930s, is one of the most recognised brands in the world. It was a franchisee, Ray Kroc, who realised how the application of a formal operations process and standardisation could provide a competitive advantage in this industry. Speed of service and quality are key performance objectives. Interestingly, McDonald's menus have a customer perception of variety; however, this is not really the case. In terms of the influence of the four Vs, variety is low. Standardisation is one of the key operations strategies used by McDonald's to achieve cost leadership. By minimising the number of ingredients and arranging them in different combinations, it is possible to provide different meal outputs. Twenty-two different food inputs can be combined in over 600 ways so that a comprehensive burger menu can be provided to customers. Volume is high through a mass process system relying on assembly lines. Visibility is low, as customers typically don't see the kitchen operations and only encounter frontline staff. McDonald's has low variation in demand, as the menu can be adapted for different seasons and therefore the level of sales remains consistent.

Scheduling and sequencing

Scheduling and sequencing tools are used to identify all steps in the operations process and organise them into the most efficient order to complete. Tools such as Gantt charts and critical path analysis are used by project managers to help in planning complex projects with multiple interrelated parts. Scheduling and sequencing tools will need information about:

- what production activities are used
- when a particular activity will occur
- how long an activity will take to finish
- what activities are independent and can therefore occur at the same time
- what activities are related so that one has to occur before the other
- what resources will be used.

Therefore, a key role of the operations manager when scheduling and sequencing is to perform a detailed **task analysis** to determine the separate parts of the entire process of making a good or providing a service. Task analysis is the breakdown of all the steps needed to manufacture a good or provide a service.



Source 3.14 Scheduling and sequencing tools such as Gantt charts help businesses to plan complex projects with multiple interrelated parts.

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Source 3.15 A simple Gantt chart, in which production is based on customer orders

Order no.	Customer	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6
011	Dao						
012	Johanssen						
013	Carbone						
014	Manolis						
015	Yeong						

Gantt charts

One of the most common scheduling techniques is the **Gantt chart**. A Gantt chart records the number of tasks involved in each particular project and the estimated time needed for each task. The business can set specific dates for the completion of each stage of operations.

Gantt chart Records the number of tasks involved in each particular project and the estimated time needed for each task, but will not show the relationship between each of the tasks.

These dates are sometimes referred to as 'milestones'. At each of these points, critical decisions may need to be made. A business that organises production based on customer orders may use a Gantt chart for production scheduling. The chart may show the schedule for orders on a day-by-day or week-by-week basis, using bars to show the starting and completion dates for each order. In this case, the milestones would allow the firm to quote the dates for the completion of future orders and be the basis for rostering additional staff and determining the schedule for future business operations.

The Gantt chart allows the business to compare actual progress to its originally planned progress. Businesses that do not keep to production targets may find that their customers move to other suppliers.

Video 3.1 How to create a GANTT chart

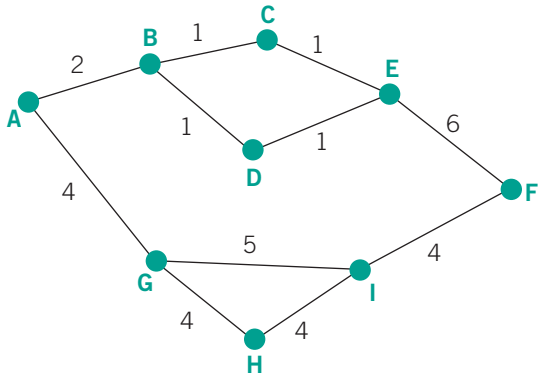
Critical path analysis

A **critical path analysis (CPA)** is an appropriate scheduling tool for use in an operation that involves a series of repeated tasks. The 'critical' aspect is those tasks that cannot be changed without having an impact on the time it takes to complete the operations process.

Critical path analysis (CPA) A scheduling tool used in an operation involving repetitive tasks, especially if the exact time each task will take is known.

Video 3.2 Critical path analysis

A CPA flow diagram shows the interrelationship of tasks. As all tasks need to be completed for the project to be finished, the critical path time period is the longest path taken to complete the whole project. To calculate the critical path, all the parts that make up the longest path are added together. This gives the shortest time without delays. In the CPA shown in Source 3.16, the longest path is from A to G to H to I to F = 4 + 4 + 4 + 4 = 16. Therefore, the completion time for this business would be 16 weeks.



Source 3.16 A critical path analysis.
Note: each number indicates how many weeks it takes to complete each stage or task.

Note: in Source 3.16, some of the components at G need to be processed through H before they are joined together with the other G components at I. Think of the paths as being like a book, where the front cover has special pictures on it and the back cover is blank. The G to H to I path may be like the front cover, which takes longer than the process from G straight to I, which could be the back cover.

An effective operations manager will also include the effects of delays. In addition, the finance manager can use CPA to organise the

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correct amount of funding for the operations process and determine the impact on cash flow.

Technology, task design and process layout

Technology is often understood as highly specialised equipment and computers used by a business or in a factory. Task design and process layout will be used by an operations manager to use this technology in the most efficient and effective way.

Technology

Technology is a key input into the operations process. A business may wish to achieve a sustainable technological advantage over its rivals by using leading-edge technology – that is, the most recent and innovative technology – in its operations. A more conservative strategy would be to use technology that has already been established, tried and proved in operations without the risk of investing in a new technology that may fail.

Computer-aided design (CAD), computer-aided manufacturing (CAM) and robotics are technologies used in operations processes, and have been described in Chapter 2. The improvements in the machines, equipment and devices used to transform inputs into outputs are called **process technologies**.

Process technology The improvements in the machines, equipment and devices used to transform inputs into outputs.

Even the most labour-intensive industries use process technology. For example, a local organic farmers' market may use wireless EFTPOS (electronic funds transfer at point of sale) machines so that customers pay with Visa payWave, MasterCard PayPass or their mobile phone. Product technology is quite different, because this is innovation in the products themselves. Smartphones are a good example of an innovation in analogue mobile phones.

Technology can improve the competitiveness of operations by giving it more flexibility, as it allows the business to respond to changes in the market more easily. The business can

Business Bite

The evolution of manufacturing is being called Industry 4.0 with the application of digital technology. Artificial intelligence (AI) first appeared in 1965 and has found its application in business operations at an exponential rate. Manufacturing businesses are looking for efficiency gains rather than relocating operations to a low-cost country. Competition requires businesses to be more flexible, producing made-to-order goods incorporating just-in-time, lean manufacturing with smaller inventories. Operations are using robots and automation combined with AI and machine learning to analyse massive data sets in real time to train machines to perform tasks. This technology can be used to identify input problems and inefficiencies in the operations process, diagnose solutions and teach other machines these solutions without being programed. At present, AI, robotics and automation dominate in automotive and consumer electronics manufacturing and will increasingly be used in the service sector to gain a sustainable competitive advantage through customisation of outputs to suit the individual needs of consumers. However, the change in operations impacts the human resource function as employees need to be recruited and trained to take on new roles and responsibilities that occur with the introduction of AI technology.

Source 3.17 Robotic arms work at an intelligent furniture factory using 5G and artificial intelligence (AI) technologies, Ganzhou, China.

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change volumes to meet a sudden increase in demand or produce different variations of products to satisfy changing consumer demands. Technology also allows a business to produce non-standardised versions of its standard product to satisfy individual clients. This is in addition to the commonly understood improvements to productivity: less waste and more efficient use of time.

Perhaps the most significant impact on businesses from process technology in recent years is the application of computer software modelling programs, the internet and wireless communication to the operations process.

Flexible manufacturing systems (FMS) are an integrated approach to using technology and will have an impact on task design and the layout of the manufacturing facility.

This type of manufacturing can perform multiple tasks at once, reducing the number of individual tasks performed by separate pieces of equipment. Rather than have a process or a product layout, the business may have semi-independent automated workstations to which all the inputs are transported.

Task design

The operations process determines what tasks are to be completed to finish a project. Management decides how each task will be completed. This is referred to as **task design**.

Each individual task is analysed and broken down into separate steps and allocated to machines and employees with the appropriate skills, knowledge and capabilities.

Task design Deciding how a task will be completed.

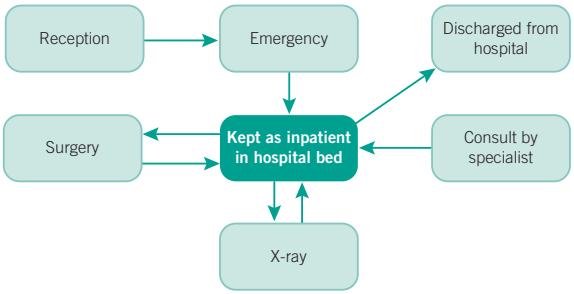
Source 3.18 The operations process determines what tasks are to be completed to finish a project. Management decides how each task will be completed, through a process known as task design.

Some employees may need training to improve their skills. Even if the process of operations is already established, task design allows ongoing analysis and adjustments in each activity to ensure continuous improvement in productivity. New ideas, technological change, training and the skills of the workforce available will necessitate continual revision of the operations process in order to maintain competitiveness.

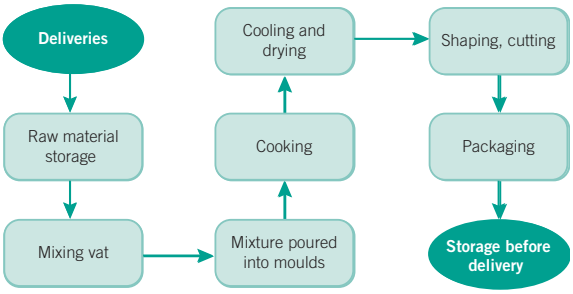
Process layout

Once the task has been analysed and the technology requirements determined, the next strategic decision is to plan the physical layout of the business's factory or office. This is called facilities layout planning. Layout will also be influenced by the size of equipment, work areas and storage space. The objective is to have as efficient a flow of resources through the business as possible.

A process layout is one in which all the machinery is arranged by what it does (that is, the functions used to make the good or provide the service). The product moves from department to department, depending on what transformation is needed. This allows for more flexibility and customisation of the product. This is also known as a functional layout.



Source 3.19 Process layout diagram for a patient in a hospital



Source 3.20 Product layout diagram for a food manufacturer

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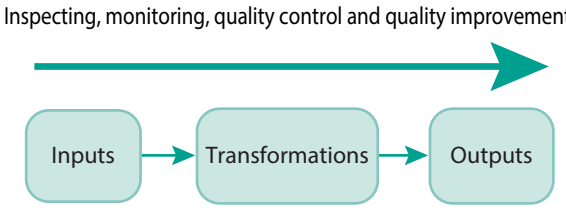
Illustrative examples include a factory such as a bakery, where some food items will need decorating and others will not; or in an office, where certain roles are placed together, such as marketing or human resources. A process layout requires staff to be specialised and know how to use the equipment and tools in their department.

Process layout is quite different from product layout, in which the product moves from station to station, such as in a car assembly line. Product layouts are used for assembly line manufacturing to make a particular product or good.

Monitoring, control and improvement

No matter how well managed they are, operations can always be improved. Monitoring, control and improvement relate to performance objectives of quality, speed, dependability, flexibility, customisation and cost in operations. Quality management systems are discussed in detail in Chapter 4. Monitoring, control and improvement are illustrated in Source 3.21 as they occur at each stage of the operations process.



Source 3.21 Monitoring, control and improvement occur at each stage of the operations process.

A business needs to know accurately how well its current operations are working in order to make improvements. Managers will find it difficult to assess the performance of operations and make improvements without adequate information. Data will be collected about the following:

- operations costs
- the amount of waste from operations, such as leftover materials
- the number of defects and substandard goods
- the quality of the product
- the speed of manufacturing or response time to customers' requests
- the volume of output.

This data is also called key performance indicators (KPIs). KPI reports are used to monitor operations with respect to key performance objectives.

Key performance objectives of operations will not be achieved without adequate monitoring of operations and controls to ensure that operations are 'on track' and that strategies are used effectively to make improvements.

The purpose of monitoring and control is to ensure that the operations process runs efficiently and effectively, producing the goods and services it was designed for. Control is a management function that aims to keep the business's actual performance as close as possible to what was planned by making adjustments to the operations process. It is coping with changes as they occur (for example, changes in demand).

Adjustments and changes may need to be made to day-to-day activities for the short term, and even the entire operations process for the long term. Effective controls ensure that the business makes and supplies an appropriate quantity of its products, in an appropriate time and to the required level of quality according to what is planned.

Key questions that must be answered by the manager are whether the current operations are satisfactory and where improvements can be made.

Improving operations is a key strategic goal of all businesses. Businesses will compare themselves against competitors and industry benchmarks in order to determine areas that need improvement. Generally, a business will seek a competitive advantage through improvements in the following areas of performance:

- quality – by getting it right the first time and having defect-free products and error-free services
- speed – by increasing speed of production and delivery of services
- dependability – by being on time with a reliable operations system, equipment and employees
- flexibility – through having processes that are able to change and offer new products and more choice
- cost improvements – by being efficient and productive to offer more value.

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Source 3.22 Key performance indicator (KPI) reports are used by businesses to monitor operations and judge how the business is performing.

Source 3.23 Monitoring, controlling and improving process

In this manner, improvements in operations will be the source of competitive advantage for the business. The challenge is to maintain continuous improvement, and a system like total quality management (TQM) will assist in obtaining this.

Review 3.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Identify a business in which visibility is a critical success factor.
2. Describe how the business life cycle will impact the transformation process. Refer to the operations volume and variety in your answer.
3. CTP Plastics produces takeaway food containers for restaurants and fast-food outlets. Briefly explain which performance objective is most appropriate for CTP Plastics.
4. Describe how KPIs can be used to improve operations.
5. Distinguish between task analysis and critical path analysis.
6. Outline two advantages of using scheduling and sequencing tools.
7. Explain how Gantt charts can be used as a method of quality control.

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3.3 Outputs

The purpose of the operations function is to produce outputs that have a value to customers that is greater than the cost of its inputs. Outputs are the final products or services that a business offers to customers. Customers may be final consumers who are members of the public, or other businesses. Businesses in resources and industrial markets supply outputs that are used by other businesses as inputs.

For example, cotton fibre produced by a cotton farm will be an input for a clothing manufacturer. Waste, defective products and worn-out machinery may be considered a secondary output.

Source 3.24 Outputs from different industries

Industry	Output
Banking	Financial services such as home loans and investment advice, security for savings
Education	Socially responsible young adults with knowledge and skills to learn, adapt and work, and related abilities
Construction	Buildings, homes and roads that meet the specifications of architects, designers and engineers

Consumers understand the difference between the physical product they buy and the services provided by businesses. However, customer service is also an output of all businesses and can be considered an essential part of what manufacturing-based businesses provide (for example, providing advice on how to use outputs in the most cost-effective way). Goods-based businesses can achieve a competitive advantage through improvements in customer service.

Customer service

Within the vision and mission statements of most businesses is a promise of good customer service. Customer service is an intangible output that requires extensive contact with customers, is labour-intensive and is immediately consumed. While physical goods can be reused, customer service can only be used once. Customer service as an output is very difficult to measure. When a business cannot achieve a competitive advantage with a better product, it can differentiate itself as better than its competitors because it has better customer service. Customer service is provided to customers before, during and after a purchase.

All businesses provide some degree of services because services are benefits that accompany physical goods. Customer service is a particular output of service-based businesses; however, all manufacturing businesses must realise that they also provide services.

Many businesses aim to have a comprehensive service system (that is, policies and procedures on how to manage relationships with customers). It may be as simple as a sales assistant in a clothing store being trained to follow a script to successfully sell and upsell (that is, persuade a customer to buy something extra or more expensive), or more complex and strict rules, covering every situation, about how to handle customers. Good customer service will increase consumer satisfaction and contribute a competitive advantage because it can create long-term relationships and therefore brand loyalty.

Customer service can include the following:

- handling customer returns promptly
- answering questions and providing information
- frequent and meaningful communication
- anticipating customer needs
- updates and advice on new products
- following up customer enquiries and complaints
- using technology to offer a 24-hour service: email, Facebook, Instagram.

Technology has changed the way customer service is delivered in many industries. It has created the opportunity to cut costs on customer service. Internet sites and automatic telephone-answering computers with voice recognition software reduce the need for staff. However, some businesses are restoring the human touch, as service is an emotional experience, and frustrated, alienated customers may leave the business.

Good customer service is an aspect of relationship marketing and can enable a business to charge higher prices and lessen the need to reduce costs elsewhere in the business. The outcome of

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good customer service is that customers buy and keep returning. It assists in maintaining the 80/20 relationship; that is, 80 per cent of revenue comes from 20 per cent of the customer base who return to the business. If a business can combine excellent customer service with a high-quality good, then it can command a premium price in the market and still achieve a significant market share. Customer service can be measured by looking at the number of customer complaints or even the average response time it takes for a business to respond to a customer enquiry.

In a school, the ratio of teachers to students is a measure of the quality of customer service, although the quality of delivery may vary from teacher to teacher.

In a global business, the challenge is to replicate its service system in all of its locations. There will be challenges arising from differences in language and culture. Training in customer relations and the customer service policies of the business will be very important to achieving consistency in service delivery.

Business Bite

Hotels provide accommodation, food, drinks, events and even transportation services. The room itself can be considered a key transforming resource, and therefore the core output is comfort and hygiene. Hotel cleaning staff are the transforming human resource. Hotel operations aim to be as efficient as possible when it comes to room cleaning. Hotels need to turn around a room quickly to remove all traces of the previous guest to resell the room. The industry average is 30 minutes using checklists and a clear sequence of steps. A strict procedure must be followed to ensure the output is a clean, tidy, remade room, ready for a new guest. However, the requirements of every room refresh will be different; therefore, cleaning operations will need to be flexible. Material inputs such as bathroom personal care products, tea/coffee items and laundry bags will need to be replaced. Some 5-star hotels offer additional service outputs, such as the Park Hyatt in Sydney where every suite offers a 24-hour butler service to anticipate guest needs and comply with requests with speed and efficiency.

Source 3.25 Luxury hotels provide personal valet services for their guests.

Warranties

A warranty is an assurance that a business stands by the quality claims of the products it makes and provides to the market.

Under Australian consumer law, all businesses must ensure that the goods they sell:

- have a level of quality that is comparable to the price and product description
- are suitable for the purpose or job they will be used for
- match the product description in any advertising or promotion
- are free from defects or faults.

These responsibilities make up the statutory (or implied) warranty that gives consumers legal protection under the *Competition and Consumer*

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Act 2010 (Cth) in Australia. Retailers and manufacturers must comply with the warranty and may need to provide a replacement product if a consumer is not satisfied. Generally, it is the responsibility of the seller to organise this and take the problem to the manufacturer. The manufacturer may replace the product or repair faulty goods with skill and care, using spare parts of a suitable quality, and then return the product or goods to the customer.

A business may offer an extended warranty above the legal minimum, such as a three-year replacement warranty. This is on top of the statutory warranty and covers the product for manufacturing defects or faults for an additional length of time. This usually comes at an extra cost, as it represents an additional service provided by the business.

Review 3.2

Analysis

Answer these questions on paper or in the Interactive Textbook.

1. Briefly explain how the outputs of one business can be the inputs of another business.
2. Explain how service outputs can provide a competitive advantage.
3. Explain why it can be difficult to achieve an increase in productivity for the delivery of a service.
4. Briefly assess the impact on operations of implementing a process layout.
5. Discuss the impact on the human resource function when a global business updates and standardises its customer service output.

Source 3.26 Customer service is a common type of service provided by many businesses. It is also an output, and enacted before, during and after the purchase of goods.

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Chapter summary

The operations process or the production process comprises the activities involved in the transformation of inputs into outputs.

Inputs into an operations system are the materials, people and facilities used to make goods or provide services. Also included as inputs are time and finance.

Transformed resources or inputs are the materials, information and customers that are changed by the operations process. Transforming resources act on the inputs to change them and are not used up in operations. These are human resources and facilities.

Transformation processes are those activities that add value to the inputs.

Businesses that produce in high volumes and low variety and experience little variation in demand will use a high level of capital equipment, technology, materials and facilities. Low-volume operations, producing a wide variety of goods and subject to a volatile level of demand, will need to have a highly flexible operations process using highly skilled labour.

Visibility of operations refers to how 'open' the operations process is to customers. The more visible the operations, the more customer-focused the business is. Operations will produce a lower volume and higher variety of made-to-order products unique to the customer's wants.

Scheduling and sequencing tools are used to identify all steps in the operations process and to organise them into the most efficient order to complete. Gantt charts and critical path analysis are the most common of these.

Process technology is the improvements in the machines, equipment and devices used to transform inputs into outputs. Product technology is the innovations in the goods and services themselves.

Monitoring, control and improvement are essential if the business is to achieve its performance objectives and sustain a competitive advantage.

Outputs are the goods and services provided to customers. Customer service and warranties are an intangible output.

End-of-chapter tasks

Chapter revision tasks

1 Match the following outputs with the appropriate businesses.

Business	Outputs
Cinema	Kitchen cabinets
Printing company	Mineral ore
Carpenter	Printed signs to order
Accounting firm	Entertained customers
Mining company	Financial reports and statements

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2 Categorise each of the following businesses as a transformer of materials, information or customers:

A transport delivery
B market research
C mining company
D dentist
E telecommunications
F retailer
G warehousing
H hotel.

3 Complete the following table by indicating the impact of the four Vs on the operations process. The first column has been completed as a guide.

	Book publisher	Bridge construction	Hospital emergency	School canteen	Soft drink bottler
Volume	Medium				
Variety	High				
Variation	Medium				
Visibility	Low				

Multiple-choice questions

1 Why are human resources classified as a transforming resource?

A Because employees will improve their skills with training
B Because employees will use their skills to add value to resources
C Because employees are multiskilled
D Because employees' productivity and motivation will vary

2 Gantt charts and critical path analysis are both tools that can be used for which activity?

A Rostering
B Scheduling
C Highlighting relationships between tasks
D Task design

3 When is a business considered capital-intensive?

A When it has borrowed a lot of capital from the bank
B When it is based in a capital city
C When it has a very high proportion of equipment
D When it has a very high proportion of labour

4 Rasmus works for a large manufacturing business. He analyses each individual task to decide how they need to be completed and identifies the skills, knowledge and capabilities employees require.

Which of the following describes his area of responsibility?

A Global sourcing
B Logistics
C Process management
D Task design

5 Which influences will cause operations to be more labour-intensive?

A Low volume, low variety, low variation, low visibility
B High volume, high variety, high variation, high visibility
C Low volume, high variety, high variation, high visibility
D The actual production process used in the business

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6 Why are scheduling tools used in operations?

A To work out rosters for employees
B To work out when products are sold
C To create the most efficient production process
D To plan production and control operations

7 What are outputs?

A Final goods and services
B What is created and supplied by the operations process
C What is produced from combining raw materials
D The individual components used in operations

8 Which of the following businesses' operations process will be most influenced by high visibility?

A Restaurant
B Construction
C Design and development
D Recycling

9 What are the characteristics of a process layout?

A Assembly lines, robotics and CAM
B The organisation of activities according to function
C The setting out of equipment in the same sequence as the operations process
D The arrangement of all the machinery by its function

10 Which of the following lists three examples of transformed resources?

A Customers, human resources and technology
B Customers, information and materials
C Inputs, components and raw materials
D Facilities, information and technology

Short-answer questions

1 A soft drink manufacturer experiences difficulty in speeding up operations to meet higher demand in summer.

Explain one change for the transformation process that would help this business meet the demand.

2 The following is a Gantt chart for a subscription meal kit service.

Task	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Monday
Customer orders taken							
Customer orders finish							
Meal kits prepared							
Quality check							
Delivery to customer							

A Identify the day when the business commences transforming inputs.
B State the activity that must occur before delivery of the output.
C Explain the timing of the quality check.

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3 Describe the difference between monitoring and control strategies.

4 Explain how the transformation process adds value in this business.

5 A tool-making business uses 3D printing technology to manufacture custom-designed tools.

Assess the importance of customer service for this business's operations.

Extended-response question

Outline the strategic goals of operations and explain the influence of volume, variety, variation and visibility on the operations process.

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4 Operations strategies

Chapter objectives

In this chapter, students will:

- identify the activities involved in operations strategy
- investigate the importance of performance objectives
- analyse the ways in which operations strategy helps support a business's strategy
- evaluate the impact of global factors on operations strategy.

Key terms

- benchmarking
- bottlenecks
- break-even point
- driving force
- electronic data interchange (EDI)
- global web strategy
- inventory
- lead time
- obsolescence
- patent
- productive capacity
- quality assurance
- quality circles
- quality control
- restraining force
- stock-out
- total quality management (TQM)
- transport logistics
- vertically integrate
- world's best practice

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4.0 Introduction

Source 4.1 Operations strategies concept map

Operations strategies include all activities involved in the production of a good or the provision of a service. They also involve all of the influences on operations strategies. Decisions have to be made about how a business produces. Operations strategies will support the business's strategic goals and will have to be coordinated with the marketing, finance and human resource functions. An effective operations strategy will give a business a competitive advantage.

4.1 Performance objectives

Performance objectives are key areas of operations. When a business sets its performance objectives, these are part of its competitive strategy. In this manner, operations provides an opportunity for differentiation from its rivals. In order to gain a competitive edge, a business may choose performance objectives such as:

- having the highest quality goods and services
- achieving faster speed and higher productivity
- being more dependable than the competition
- being more flexible than its rivals
- offering customisation
- producing at the lowest cost.

A business that can achieve multiple performance objectives can be the industry leader with the dominant market share.

Digital quiz
Please see the Interactive Textbook to access digital activities.

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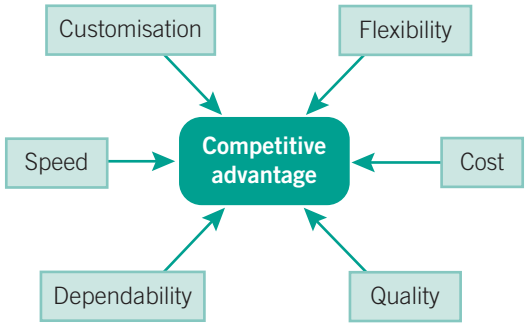

Source 4.2 Objectives that provide a competitive advantage

Quality

'Quality' has many different meanings. It is more complex to measure than physical output or costs. Quality performance objectives relate to the physical good or service, and also to the process used to produce it. For any business, the fundamental quality objective is to provide customers with a product or service that they want and which meets their expectations. Good quality prevents additional costs being caused by product recalls and repairs made under warranty.

There are many dimensions to quality that customers have expectations about, including:

- conforming to specifications – the product matches what it was designed to do and lives up to the claims made by marketing
- performance – how well the product does what it claims
- durability – how long the product lasts before it needs servicing or replacement
- features – how many options and variations are provided, as well as after-sales service
- reliability – whether the product performs the same each time it is used
- consistency – that every product has the same predictable quality
- aesthetics – how the product looks and feels
- serviceability – how easy and convenient it is to perform maintenance and repairs
- service – how well the customer is treated, the promptness of service and attention to detail.

Lead time The time it takes for a supplier to provide its customer with the goods ordered; that is, the time between the supplier's receipt of an order for goods until the delivery of those goods to the purchaser.

Bottleneck Where output is limited by one aspect of operations.

Quality is also about the operations process itself. A quality process is one that gets the operations right the first time. Value is added at each stage of the process with minimal defects or waste. There is very little variation in quality and the quality suits what is expected in the market. Statistics are often used to measure quality and gain information about variations from specifications, number of defects and waste.

Activity 4.1
Discussion

1 Discuss a brand that has the strongest reputation for quality within its industry.
2 Evaluate the quality of a particular car brand or clothing brand.

Speed

Speed is an objective because it relates to productivity. Productivity is simply output divided by input. Alternatively, it may be measured as output per unit of time. For example, a restaurant is able to prepare a meal within 20 minutes. The restaurant has a limited amount of equipment and cannot hire more staff. By keeping all other inputs the same and increasing the speed of the production process, the business calculates that it can reach its target.

Speed of operations can be increased with technology such as computer-aided design (CAD), computer-aided manufacturing (CAM) and robotics. The internet has increased the speed of service delivery, particularly in banking and finance. Faster speed in operations can reduce the **lead time** between the customer order and delivery of the good or service, which improves customer service.

There is a limit to speed as an objective because other issues may arise. The other parts of the production process must be able to keep up. A production line or operations process can only move at the speed of its slowest machine. **Bottlenecks** can appear where operations cannot handle any more increase in speed. Similar to what happens with traffic that has to merge from three lanes into two, a bottleneck occurs at the point of merging. Increased speed may increase the chance of equipment failure, and human

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Source 4.3 Some brands have a strong reputation for dependability because their products always deliver what the marketing promises.

labour can only work so fast before mistakes occur and fatigue sets in. A risk of increasing the speed of operations is that quality can fall.

Dependability

Dependability is the reliability of the product or service. How well the product is designed and made will affect how long the product works to the standard expected by customers. Some brands have a strong reputation for dependability because their products always deliver what the marketing promises. There is also dependability in delivery or supply – that is, how well the business always fills orders and distributes to the market on time.

Flexibility

Flexibility is the ability of operations to switch easily and quickly to a new model or variation of a good to meet a change in the market or changes in customer wants. There is also flexibility in volume, which is how quickly operations can change from producing few products as a low-volume producer to becoming a high-volume producer increasing output to meet increasing market demand. This will depend on the **productive capacity** of the business. Demand for a product changes according to the product life cycle. As a good enters its growth phase, a business needs the flexibility to match the increase in demand and avoid a **stock-out**, which is when the business runs out of inventory.

Productive capacity The maximum potential output of a business.

Stock-out A situation in which a business runs out of inventory.

Customisation

Customisation is concerned with how quickly a product can be redesigned, or a service can be modified, to produce a unique good or service that matches the customer's desires. Customisation may be challenging, as a business may not have the appropriate inputs or technology. There are limits on what the equipment or existing technology is capable of, on how much time is available and even on the knowledge and skills of labour.

A business with a focus on customisation will need to have close contact with customers to understand their needs and translate these into design specifications or service requirements. This is so that a unique product can be made. Customisation usually commands a higher price.

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Business Bite

Car companies are keen to reduce costs, and the rise of global platforms provides economies of scale. Millions of vehicles from different brands share parts and technology, spreading the costs of product development and manufacturing tools over more vehicles. Volkswagen produces nearly six million vehicles on its one-size-fits-all MQB platform, including models in other Volkswagen group brands such as Skoda, Audi and Seat. The result is a standardised product that may not appeal to everyone. At the other end of the spectrum is the manufacturers of customised cars that make a personal statement with performance modifications. Small workshops produce highly bespoke, unique outputs, with customisation and quality as their key performance objectives. Consequently, operations are labour-intensive, highly flexible, and focus on design and development of new products. However, lead times will be long, as the operations process will be slow, and costs may not always be below budget. Some of these workshops have made it to reality TV. *Pimp My Ride, Counting Cars* and *Diesel Brothers* are some examples.

Source 4.4 A 51-year-old *Scooby-Doo* fan and owner of the car customising company AKA Junk built this replica of the Mystery Machine.

Cost

Efficiency is a key objective of operations, and cost objectives are concerned with keeping costs as low as possible. A cost leadership strategy is used by a business to gain a competitive advantage by aiming to be the lowest-cost manufacturer within its industry. Costs must be carefully managed, and data is collected and analysed by operations managers. With lower costs there will be improved profit margins on each product sold, which gives the business more revenue. Or the business can lower its prices below those of its rivals. A key way to measure costs is to use average costs. Average costs is a very basic calculation, but is very useful for comparing overall figures. A business that can lower average costs per unit sold is obviously achieving a performance objective of efficiency.

$$\text{Average cost} = \frac{\text{Total costs}}{\text{Number of units}}$$

Source 4.5 Average cost

The operations function will be its own cost centre in a business. Costs will be allocated to different parts of the operations process, such as raw materials, overheads, maintenance, power, inventory and waste. Inventory costs will include transport (cartage) and warehousing. An operations manager will use budgets and compare cost forecasts to actual costs. In this way, cost variations can be easily identified. Investigation will reveal the reasons why some costs have exceeded expectations. In order to keep total operational costs within the objectives, cost savings may need to be found elsewhere in the business.

Costs can be categorised into two areas:

1. fixed – do not change as output changes and therefore cannot be lowered (for example, the cost of the factory building or the lease for office space)
2. variable – do change as output changes (for example, raw materials).

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Costs can also be:

- direct – directly related to production or supply of service (cost of goods sold)
- indirect – sometimes called overheads, such as salaries of administration staff, and therefore not directly related to output.

An important objective for costs involves the **break-even point**. Break-even analysis is used to determine the point at which a business starts to make a profit. A business that can reduce its costs can lower the break-even point so that it can start making a profit sooner in the business life cycle.

Break-even point When total revenue from sales equals total costs of operations. Any increase in output and sales means the business will begin to make a profit.

Source 4.6 A cappuccino machine for a cafe represents a fixed cost.

Source 4.7 Examples of how businesses meet different performance objectives

Objective	Business example
Quality	An airline that has all of its aircraft arriving and departing on schedule; friendly, helpful staff; entertainment; and tasty meals
Speed	A car manufacturer that reduces the lead time between when a customer orders a new vehicle and when it is delivered
Dependability	A retailer that always has items in stock and keeps the same opening and closing times
Flexibility	A construction company that can increase the number of houses it can build in response to an increase in demand during an economic upswing
Customisation	A restaurant that can change menus and prepare meals to suit individual customers
Cost	A soft drink bottler that can produce bottles of soft drink at the lowest cost per unit

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Review 4.1

Comprehension and analysis

Answer these questions on paper or in the Interactive Textbook.

1 Identify the main performance objective of a business supplying highly perishable food to restaurants.
2 Describe two performance objectives for a high-volume manufacturer of consumer electronics.
3 Analyse the impact of a business pursuing a quality objective on the achievement of speed and cost objectives.
4 Explain the importance of a dependability objective for an airline.
5 Assess how a performance objective of flexibility is important for a business that operates in a dynamic business environment.

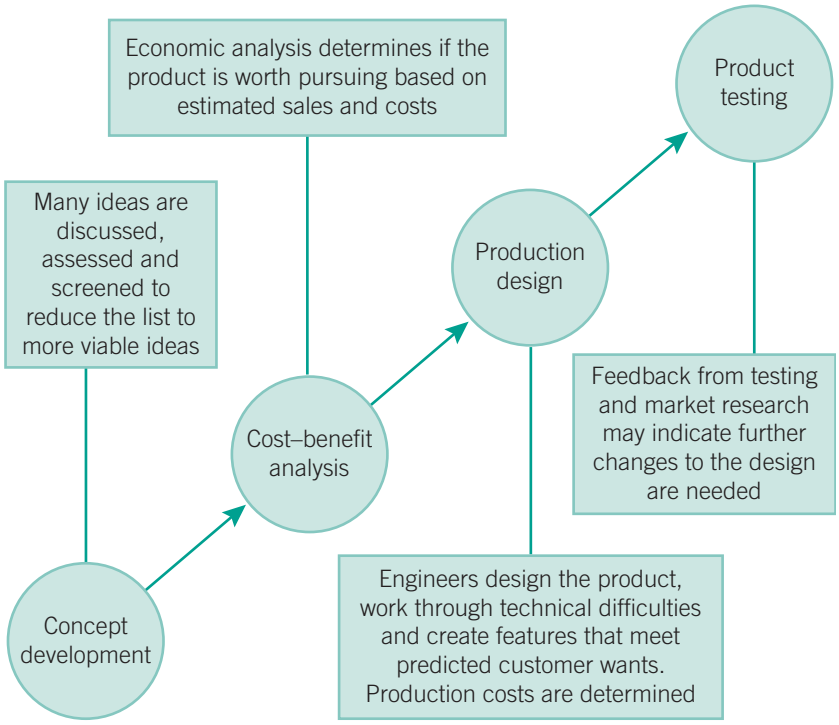
4.2 New product or service design and development

All businesses experience a decline in the sales of their products as the products reach the end of their life cycle. Often the life cycle can be extended by adding more features or improvements in design and quality. However, eventually new products must be developed and released to the market.

A business that has the core capability to integrate leading-edge technologies and innovative ideas can be a market leader in new products and services.

New product design is a lengthy process because initial research may indicate a high number of possible products that could be commercialised into a final product. Cost–benefit analysis, design, testing, construction of prototypes and market development will eliminate those ideas that are:

- too expensive to make – a financial filter
- beyond the capabilities of operations to make – a capability filter



Source 4.8 New product development process

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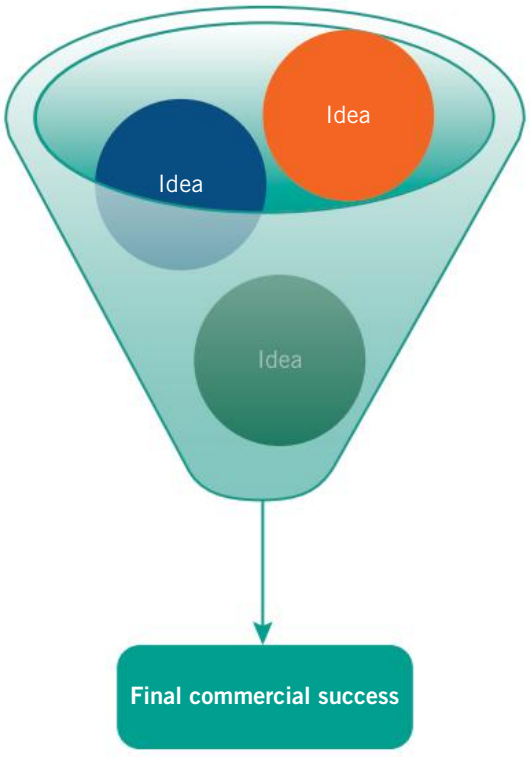
- having problems with design – a technical filter
- not going to be received well in the market – a commercial filter.

It may be the situation that, out of many products initially proposed from research, only one reaches the market to be a commercial success. The development process can be very expensive and time-consuming, and therefore many businesses choose to imitate a competitor's product. Many businesses simply do not have the financial resources, knowledge or time to commit to new product development. By waiting and imitating, a business can gain an advantage by avoiding the costs and risks of new product development. Even though they are 'second to market', their product may have additional features that give it a competitive edge.

Despite the high attrition rate, with many discarded ideas, a business will gain considerable knowledge from this process, which will be an information input into future products or services. Given further developments in technology, a discarded idea may have the potential to be a commercial success in the future.



Source 4.9 Idea elimination funnel

4.3 Supply chain management

The supply chain includes all businesses directly linked to the supply of goods or services to the consumer. Supply chain management involves all activities required to acquire inputs through to the process of distributing outputs to customers. Suppliers need to be found that can provide the most appropriate inputs at the best price and reliably supply the required quantity with the appropriate quality. Suppliers will need to know how far ahead orders have to be made, in what quantities inputs are required, what transport facilities are available and the expected delivery times.

It is important to know the lead time involved for each supplier. As noted earlier, the lead time is the time it takes for a supplier to provide its customer with the goods ordered – that is, the time between the supplier's receipt of a request for goods and the delivery of those goods to the purchaser. Both manufacturing and service businesses need to have well-organised supply chains. In each case, the shorter the lead time, the more flexible purchasing becomes, which allows greater flexibility in production. The location of the market and the business's major suppliers may be a very important consideration. Factors affecting a business's location may

Digital quiz
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Source 4.10 Suppliers need to know quantity, transport facilities and expected delivery times.

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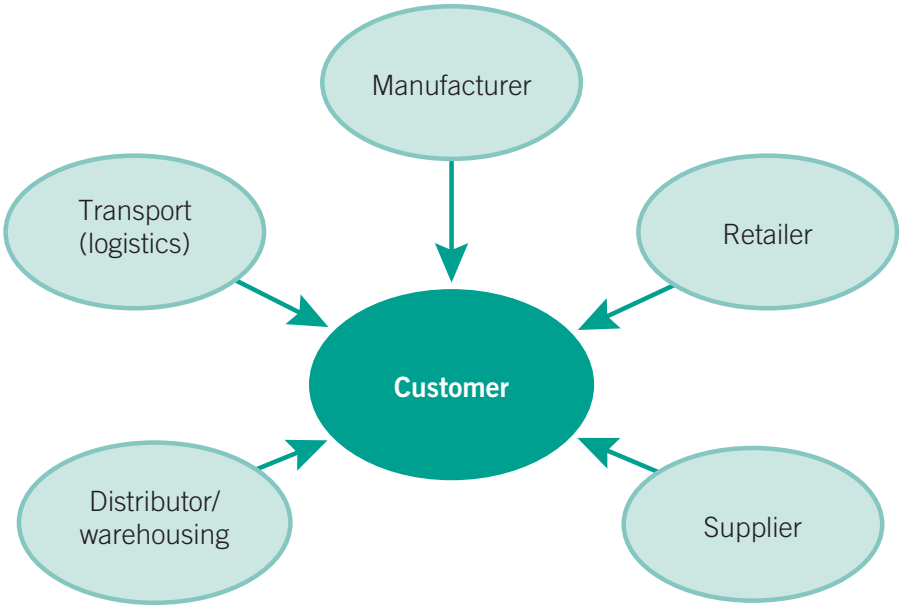

Source 4.11 Issues in supply chain management will cover day-to-day operations through to the long-term strategic goals of the business.

include the availability and cost of transport, perishability of inputs and outputs, distance to markets, whether the inputs and outputs have fragile components and the availability of labour. These factors will influence the initial location of the business. Relocation may be necessary if changes in external factors influence costs and therefore profitability.

Many businesses do not own or control their source of materials or their distribution channel. This is a consequence of outsourcing and developments in information technology, making it possible for businesses to focus on their prime function. More recently, businesses have tried to rationalise (reduce) the number of suppliers from which they purchase to reduce costs. Businesses may enter into longer-term contracts with their suppliers. This may establish a better relationship between suppliers and the business, which benefits both in various ways – for example, improved trade credit terms, possible cost reductions due to bulk purchases, improved reliability of supply and better quality of service. Businesses do not necessarily choose the cheapest supplier but will aim for value for money and reliable supply. The objective of having the right materials (inputs) available in the right place and at the right time will be achieved.

This will allow the business to achieve its short-term objectives (such as reaching a particular production target or reducing operational costs) and move towards the goals set out in the strategic plan (such as to achieve a certain level of profit within a specified period of time). Therefore, supply chain management involves the coordination of all these factors so that goods and services can be delivered to customers in the quickest, most dependable and cost-effective manner.

With greater specialisation in manufacturing during the 1990s, industries and individual businesses increasingly outsourced the management of their supply chain. This created an opportunity for businesses to provide supply chain management as a professional service. A new industry developed around organising and planning supply, transport and communication systems for supply chain management. This enabled larger businesses that could afford this professional service to focus on their core operations, especially those operating on a global scale.

As an alternative to outsourcing, a business may wish to have greater control over its supply chain by vertically integrating. This means purchasing a controlling interest in other businesses in its supply chain – either in the business that supplies its inputs (backwards vertical integration) or those to which it supplies. This is quite different from horizontal integration, in which a business will acquire a competitor in the same industry, thus increasing its market share.

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Source 4.12 Supply chain management goals

Strategic – long term	Tactical – medium term	Operational – short term
Warehouses: number, size and location	Sourcing raw materials	Taking orders from customers and setting production targets
Location of manufacturing	Scheduling and sequencing production	Delivery of products from warehouse
Future partnerships with suppliers and distributors	Inventory decisions: quantity of stock stored, quality of inventory and location	Receiving deliveries and storage of inputs
Updating information technology and communications systems	Transport of products	Planning current inventory levels to match forecasts in demand from customers
Integration of new products with existing products that are at the end of their product life cycle	Identifying patterns in the changes of consumer demand	Communicating with suppliers
Researching innovations in supply chain management	Comparing the business against its competitors and industry benchmarks	Managing damaged goods and goods returned by customers and distributors
Reducing lead times	Identifying and preventing bottlenecks in the supply chain	Responding to changes in level of demand

Business Bite

By mid-2020, the impact on global supply chains from the COVID-19 pandemic on Australian businesses was clearly evident. The coronavirus disruption meant many firms were unable to obtain the inputs required for manufacturing. The situation was worsened by just-in-time inventory management, as these businesses did not have any buffer stock on hand to keep producing. Consequently, many businesses are re-evaluating just-in-time strategies and over-reliance on foreign suppliers and complex global supply chains. Although Australian manufacturing only represented $104.5 billion or 5.5 per cent of gross domestic product (GDP) in 2019–20, the sector is projected to benefit from reshoring and securing domestic suppliers to avoid the risks of future global shocks. This would lead to a growth for small and medium-sized local manufacturers who produce critical parts, components and other intermediate goods for use as inputs by other manufacturing firms. The government is very keen to boost Australia's manufacturing self-sufficiency, particularly for medical products and equipment.

Logistics

Logistics involves the transport, storage and handling of physical raw inputs and the distribution of physical outputs to markets. It is the part of the supply chain that focuses on moving inputs, resources and outputs through the supply chain as quickly as possible, saving time at each point in the supply chain. The goal is to achieve an efficient, steady flow of material throughout the supply chain.

Correct and timely information is crucial for successful logistics management. For example, the operations manager will need information about how long it takes for inputs to be physically

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Source 4.13 Business logistics experts are required as a specialised job in operations management.

transported from their source of origin to the factory. Sophisticated software programs can be used to identify where efficiencies can be gained.

Logistics is necessary as the supply chain is increasingly globalised, making it ever more complex to supply businesses with materials and move products. Business logistics experts are required as a specialised job in operations management. The role of logisticians has been defined as to ensure that operations have 'the right item in the right quantity at the right time at the right place for the right price in the right condition to the right customer'.

Specific tasks include:

- inventory management
- purchasing inputs
- transporting inventory and products
- storage and warehousing
- packaging
- planning and scheduling.

Therefore, logistics is not concerned with merely the transport of material, but also with strategies to save time and control the flow of materials that add value to the supply chain and the operations function.

E-commerce

Electronic commerce – or e-commerce – is a part of e-business. It is not to be confused with the term 'e-tailing', which is used to describe businesses that only use a virtual store and sell their goods and services through a website. E-commerce is a more precise term and identifies the use of the internet to both buy and sell goods and services. The internet has significantly increased the amount of business-to-business (B2B) communication and business-to-consumer (B2C) interaction.

Changing consumer attitudes towards 'virtual' shopping have seen a significant increase in e-tailing or online retailing. Many consumers enjoy the convenience of browsing products at their leisure without suffering high-pressure selling techniques. Having at least an online catalogue is almost a necessary part of promotions strategy. Owing to the time and expertise required to set up effective web communication, many businesses are outsourcing this function to information technology (IT) experts.

Source 4.14 In 2020, lockdowns around the world due to COVID-19 led to a significant increase in online shopping.

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E-commerce uses **electronic data interchange (EDI)**, email and software such as Skype to have real-time conversations with suppliers and customers, and exchange data and information. In operations, thousands of businesses that sell products to other companies have discovered that the internet provides a 24-hour promotion for their products and a quick way to reach the right people in a business, such as purchasing officers, to give them more information via email.

Inventory management can be improved with e-commerce – it can be set up so that an email to a supplier is automatically generated when inventory levels are getting close to buffer stock levels (the minimum stock a business likes to carry to meet demand). This improves efficiency in the supply chain because the supplier receives the message and can deliver more stock just as the business needs it for just-in-time (JIT) inventory management.

E-business is a broader term that refers to the use of the internet to carry out a variety of business functions such as finance, marketing and even online training programs for human resources.

Global sourcing

Countries throughout the world have different endowments of resources, and globalisation has enabled businesses to access resources that were previously beyond their reach. For example, Australia has a huge supply of iron ore and coal, which is supplied to steel mills in China. Resources and the raw material inputs are not available everywhere, and their geographic location will influence where a business chooses to:

- locate manufacturing
- locate assembly
- purchase inputs.

Global sourcing is finding the most cost-efficient location for purchasing inputs or manufacturing a product, even if the location is overseas. By locating closer to its raw materials or to where there is a source of cheap labour, a business can achieve lower costs. Many multinational corporations (MNCs) choose this strategy and even have a global web of operations to take advantage of the lower costs available in different countries. There may be an additional incentive of low rates of tax to encourage global businesses to establish in certain countries and stimulate the local economy.

MNCs that use this strategy must keep careful control over their supply chains that cover a global network of suppliers and distributors. There is a much greater risk of disruption to the supply chain owing to events beyond the business's control, such as political unrest or a natural disaster. An additional issue is that relocating manufacturing may not create a sustainable advantage and the business may need to relocate again and again because competitors will go further and further to cut costs.

Electronic data interchange (EDI)
Use of computers, barcodes and scanner systems to monitor individual stock items and keep accurate records of inventory levels.

When sourcing its inputs a business may use a 'buy strategy', where it will purchase and import all its inputs from an overseas supplier that specialises in providing those materials. The advantage of this strategy is that the business is free to concentrate on its core business activity. The supplier may also offer a good supply of high-quality inputs at a discount price when the business orders in bulk. The inputs may also be well designed and constantly being improved by the supplier to suit its business customers. However, there may be a threat to the business if competitors are also able to buy the same inputs, as this will reduce any competitive advantage the business has.

Source 4.15 Globalisation has enabled businesses to access resources from locations that were previously considered too distant. This stencil describes the contents of a wool bale that is being exported.

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Business Bite

Operations in the clothing industry needs to supply the right fashion products, at the lowest possible costs, at the fastest speed, while simultaneously maximising profit. Zara is one of the world's most recognised brands. Its fast fashion business model is dependent on flexible operations and responsive supply chains to sustain its competitive advantage. The company has spent more than 30 years perfecting its unique real-time supply chain and inventory management system. Zara purchases in bulk only 4–5 types of fabric a year, as inputs, from its suppliers in Italy, Spain, Portugal and Greece. Orders are delivered within five days, by truck, to its central automated distribution centre called 'The Cube'. Each of Zara's 11 nearby factories is connected by underground monorail to The Cube. Fifty per cent of Zara's output is made in these factories, 26 per cent sourced from other European factories and the remainder from Asia and Africa.

With such short lead times of 4–6 weeks from inspiration to store arrival, Zara is able to respond quickly to monthly changes in consumer demand and fashion preferences. Its factories can quickly increase and decrease production rates according to short-term forecasts, so there is less inventory in the supply chain, reducing waste and costs. Clothing outputs are distributed from Zara's logistics hub in Zaragoza, arriving at Zara's stores in China and the United States in just 48 hours, and in three days to its stores in Japan. Efficiency and speed in distribution mean that store managers can order and receive stock within a few days. Stock arrives on hangers with price tags, ready to display.

The benefit of Zara's operations process and inventory management is that it provides a product differentiation strategy. Zara produces approximately 11 000 distinct designs per year, with changes to clothing designs every two weeks, on average. Limited production of the most current styles offers consumers more choice. Thus, Zara finds that only 10 per cent of finished inventory is unsold, compared to the industry average of 17–20 per cent. This allows the company to avoid heavy discounting and sending clothes to landfill.

Source 4.16 Zara is one of the world's most recognised brands.

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When a business decides to **vertically integrate**, it buys out the business that it sources its inputs from or, alternatively, purchases the business that it supplies to. This is so that it can make its own secure supply of good-quality raw materials and inputs, or ensure the distribution of its outputs. Other advantages of this strategy are that it allows the business to:

- reduce costs through economies of scale and remove the profit margin a supplier would make from selling the business the inputs
- control when materials are delivered
- control the quality of materials.

The business will also need a transport system to bring inputs and send outputs to where they are needed. This is sometimes called **transport logistics**.

Vertically integrate When a business purchases a controlling interest in other businesses in its supply chain.

Transport logistics The organisation of the physical movement of inputs and outputs from their point of origin to their destination. The route, method and speed of transportation are all factors to consider when delivering inputs and outputs.

Source 4.17 Comparison of sourcing decisions

Advantages of making inputs	Advantages of buying inputs
Lower costs when economies of scale achieved	Lower costs from selecting cheapest supplier
More control over design, quality and timing of delivery inputs	May be possible to source better quality inputs in the quantities required
Ability to protect technological innovation advantages	May be cheaper when business only requires particular inputs in small quantities
Ability to respond to changes in volume, variety, variation in demand and visibility	Business can cancel order if the supplier changes its processes and quality changes, giving flexibility
Easier to protect corporate secrets	No need to invest in a factory

Review 4.2

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Define the term 'logistics'.
2. Describe the supply chain of an online retailer of mobile phones.
3. Explain why cost minimisation is not always the best strategy when managing a business's supply chain.
4. Analyse the impact of global sourcing on a business's supply chain.
5. Evaluate the importance of supply chain management for a business supplying fresh fruit and vegetables to supermarkets.

4.4 Outsourcing

Outsourcing is the contracting out of a non-core business activity. A business may wish to focus on its main activity, and so organises another business to provide a support service such as transport, security, supply chain management, logistics, maintenance and servicing of equipment, producing components or supplying materials. By outsourcing, a business can free up resources to invest in the core business activities.

An impact of globalisation is that market conditions can change, which may cause a change in the cost of materials and other inputs; for example, cheaper raw materials are available from new sources. If the business's supply chain is not flexible enough to move to a different supplier, then any advantage from outsourcing may be lost.

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Another impact of globalisation is the opportunity to outsource to an overseas supplier, known as offshoring. For example, many IT, software and banking administration tasks have been sent offshore to India to take advantage of less expensive yet skilled and educated labour with faster turnaround times for work. There is a large pool of English-speaking, talented and motivated young workers, many of whom are graduates from India's universities. When offshoring, however, there is a risk that a business can lose its knowledge and capabilities. In essence, the business may be hollowed out as internal departments are closed, local employees made redundant and tasks shifted to an outside supplier.

Source 4.18 Advantages and disadvantages of outsourcing

Advantages

The business to which the service is outsourced can offer:

- access to specialist knowledge and expertise because the function is their core business
- more efficient methods
- specialist knowledge of relevant laws and regulations
- better access to IT, technology and the most suitable equipment
- experience at solving complex problems
- lower costs, as the contracted business can achieve better economies of scale, which can be passed on
- increased quality of outputs.

Disadvantages

Disadvantages can include:

- breakdowns in the outsourced business, which affects the entire operations
- loss of control over quality, reliability and even costs
- possibility that loss of control may be exaggerated with the business being located in another country (cultural incompatibility)
- possibility that a competitor outsources to the same business, which may eliminate a competitive advantage and even expose the business to rivals discovering commercial secrets
- lower lead times and response to changes in the market
- poorer relationship with stakeholders such as the local community and redundant employees.

Activity 4.2
Comprehension

Read the article 'Call centres and compromise: the changing face of outsourcing' that is available on The Conversation website and then answer the following questions.

1 Identify two service-based industries that have traditionally used outsourcing.
2 Outline an issue that has occurred when outsourcing aspects of operations overseas.
3 Explain why a business would choose to outsource aspects of its operations overseas.
4 Analyse the impact of outsourcing on the Australian economy.
5 Undertake additional research to define and explain the term 'omnishoring'.

Digital quiz
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4.5 Technology

Businesses operate in a dynamic environment. One of the major external influences on business is technological change. Technology is the equipment, materials and knowledge available to help businesses perform certain functions or make products. Technology can result in the development of new methods of production or new equipment that helps businesses perform functions more quickly and often at a lower cost. There is a heavy reliance on the operations manager to be aware of this technology and assess its application to the business. The manager will weigh the costs of the upgrade in technology against the long-term expected benefits, such as increased sales or higher profits.

In operations, the implementation of technology has three broad aims:

1. to save time and money
2. to introduce new products or services
3. to give business better control over operations, particularly quality.

Source 4.19 Customers place their order and pay for it without engaging with a McDonald's staff member. The order goes automatically to the kitchen and records the impact on the inventory.

When making a decision about technology use, a business must take into account various factors, including:

- the speed of change taking place in that area of technology
- the technology that competitors are using
- the implementation costs
- how easily new technology can be integrated into existing operations
- the finances available for a change in technology
- how long it will take to introduce the technology (especially if all work needs to be at a standstill)
- whether staff will need to be retrained or made redundant.

The evolution of computer technology has resulted in major changes for service-based businesses as well. The use of computers as word processors, storage systems and communication systems has changed the way businesses record and process information about transactions, employees and general data. It has even enabled people to work from home.

Leading-edge

In a highly competitive market, many businesses seek a competitive advantage by being the first to develop and implement new technology. Having leading-edge technology may be referred to as being at the 'cutting edge'. A business that can incorporate leading-edge technology will force its competitors to follow it if they also wish to remain competitive.

Established

This type of technology has been tried and proved and is therefore very reliable and dependable.

Types of established manufacturing technology include CAD, CAM and robotics, as described in Chapter 2. The internet has been a business tool since the mid-1990s. Computer modelling software is used to integrate all parts of operations management to find cost and time savings. Office technology, such as business intranet, smartphones and electronic funds transfer at point of sale (EFTPOS), has been used to offer better services and faster service delivery to anywhere in the world.

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Source 4.20 Examples of leading-edge technology

Industry	Leading-edge technology
Agriculture	Using Global Positioning System (GPS) units to precisely map areas for planting and ploughing, direct equipment and fertilise with little human intervention
Education	Delivery of all course materials online; tutorials using blogs, forum posts and videoconferencing; submission of assignments using email
Regenerative medicine	An extracellular matrix powder created from pig bladders, which can help tissue to regenerate. It is a combination of connective tissue and protein that can be used to repair tendons and other human tissue. It may be used to regrow lost limbs and damaged organs.
Transport	Carbon-fibre composites are very strong, lightweight materials used in the manufacture of aircraft, vehicles and other devices requiring high strength and light weight.
Electronics	Graphene can be used to make lighter, stronger, more flexible and more efficient screens and displays.

Two more examples of established technology are electronic data interchange (EDI) and project management software. As mentioned earlier, EDI involves the use of computers, barcodes and scanner systems to monitor individual stock items and keep accurate records of inventory levels. Today, with the use of EDI in conjunction with inventory management software and rationalisation of suppliers, many businesses maintain relatively low inventory levels to reduce costs. In order for this system to operate efficiently, there must be close communication between the functional departments and the business's major suppliers.

Inventory Includes the raw materials and input supplies used in the production process, the goods that are partially processed and the firm's finished products, which are also known as stock.

Computer modelling or project management software for operations can be used to create Gantt charts and perform critical path analysis. Software such as Microsoft Project allows an operations manager to precisely plan and schedule operations because lead times, delivery times, inventory requirements, task analysis, labour needs, equipment and even breaks for maintenance can be entered into the model to calculate the most efficient sequence and schedule. Regular reports can be produced so that operations managers can monitor the progress of operations and take corrective action if needed.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Activity 4.3
Research

Research the latest, most leading-edge innovation in an industry of your choice. Briefly summarise the impact of this innovation on the operations strategies.

4.6 Inventory management

The terms '**inventory**' and 'stock' are often used interchangeably, but both refer to a business's resources. Nearly all businesses have an inventory of raw materials, work-in-progress and finished goods, as well as information resources and customers. In the case of service-based businesses, queues of customers represent customer inventory. For goods-based businesses, the warehousing and care of inventory can be very expensive. Inventory may account for 30 to 50 percent of the total assets of the business. Therefore, inventory management and control becomes a very important procedure. Controlling the level of inventory in a business is important because the business must hold enough stock to meet demand, but not too much. Too much inventory will increase storage costs, while not having enough stock on hand will result in lost sales and potentially damage the business's reputation as a reliable supplier. Ultimately, a business will need

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to balance its inventory expenses with the need to meet changing demand. Technology has made inventory management much more efficient and accurate. Many businesses use barcodes and electronic barcode readers to keep track of what they have, what has been sold and the exact location of stock.

Businesses monitor and control inventory levels so that they:

- do not accumulate dead stock (stock that is old, out of date or unable to be sold)
- can identify slow-moving stock for discounting and deletion
- can maximise the sale of fast-moving items
- can identify stock losses from theft, expiration or damage.

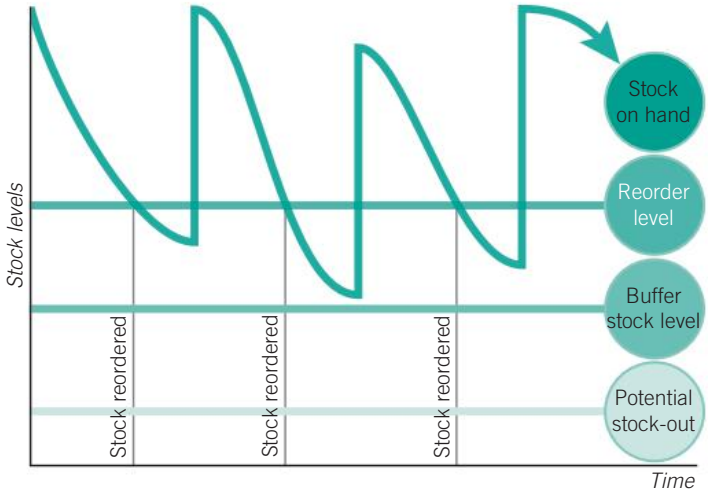
Inventory management involves making decisions regarding how much stock to have on hand at any one time and the most appropriate systems of storage and methods of handling. Management takes into account such factors as:

- the time needed for various supplies to be delivered
- cartage and freight costs
- perishability or life span of the product and its components
- seasonal patterns in demand
- insurance premiums
- costs of handling and packaging.

In order to have the ideal level of inventory, an operations manager will consider the following questions:

- At what stage of the life cycle is the business?
- At what stage is the product life cycle?
- What is the trend in the size of the market – growing or shrinking?
- What is the inventory turnover? Is the product a low-profit-margin, fast-selling item or a high-profit-margin, slow-selling item?
- How perishable is the product? What is its use-by date?
- How much storage space is available and what is required?
- What types of funds are used to finance the purchase of the stock? Can the business reduce financial costs by using commercial bills or other forms of debt finance with a longer term than an overdraft business credit card?
- Will there be enough staff to manage the delivery and storage?
- What security or special storage requirements are needed?

Inventory management can be as much an art as a science. Managers will use their past experience, and knowledge of the business and the market to hold as efficient a level of stock as possible. However, sophisticated software programs and computerised inventory management systems that can update records, generate orders and forecast demand have made inventory management much more precise.



Source 4.21 Inventory management to ensure sufficient stock is on hand

Advantages and disadvantages of holding stock

Holding stock is also known as buffer stock. Using this method, a business holds a certain level of stock as a reserve to cover interruptions to supply or an unexpected increase in demand. The advantage for cash flow is that stock is ordered at more regular intervals, which reduces the pressure on the business to have a higher amount of cash readily available. Purchases can be planned so that working capital is managed more efficiently. There is usually a certain pattern to sales over the year, with predictable changes. For example, more stock will be ordered prior to Christmas for a toy store and less during January and February. Holding stock also suits suppliers that need a longer lead time (the time it takes between when a supplier is notified and stock is actually delivered).

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Other advantages of holding stock include:

- stock being ready to use as inputs or to sell
- no need to rely on suppliers for just-in-time deliveries
- opportunity for discounts when ordering stock in bulk
- ability to take advantage of a growing market domestically and overseas
- inputs and components that are able to be used as spare parts if required.

Overall, holding stock is conservative inventory management and it does keep valuable finance tied up in stock. There are warehouse expenses for storage and security. There is also the risk that inventory may become **obsolete.** For example, one of the causes of the failure of Dick Smith Ltd in 2016 was that the business was carrying excessive levels of older stock which was not selling fast enough and therefore becoming obsolete with technological developments in consumer electronics. The value of Dick Smith's inventory was falling while its inventory management costs were higher than those of its competitor, JB Hi-Fi.

Obsolescence Loss of value of, or need for, an object, service or practice by its becoming less suitable for use.

Perishable items such as food, if held for too long, can spoil. A business may have to sell stock at a large discount to recover cash if it experiences a cash-flow crisis. When there is not enough stock on hand, a business may experience a stock-out, in which there is no supply of stock available for customers. Customers may switch to a competitor as a result.

Overall, the challenge for inventory management is to have enough stock on hand to satisfy changes in customer demand and not be overstocked, so that costs can be minimised. This will give a business a competitive advantage because it contributes to efficient operations, which provides for lower prices, and customers will always be satisfied as products will be available on demand.

LIFO

LIFO literally means 'last in, first out'; that is, the stock purchased most recently is sold first. This method can be used for goods that have no use-by date, such as machinery parts. The LIFO system is actually an accounting method of recording inventory costs, and the reality of inventory management may be quite different from calculating costs for the financial statements. This is because costs for inventory will change over a year due to newer stock potentially being more expensive than stock purchased at the start of the year.

FIFO

'First in, first out' (FIFO) assumes that the first stock that has been purchased is the oldest and will be sold first. FIFO is more appropriate for perishable items such as food and drink. Imagine a supermarket where the oldest stock that has to be sold before it reaches its use-by date will be placed at the front of the shelf and new stock will be placed behind, ready to replace it as it sells. Using FIFO, the business assumes that the oldest goods are sold first and the items obtained most recently stay in inventory on the balance sheet. The impact of this cost accounting method is that closing stock on the balance sheet has a higher value, increasing the value of current assets. Cost of goods sold will be lower and gross profit will be higher than if the LIFO method was used.

JIT

The aim of just-in-time (JIT) inventory management is to hold as little stock as possible and only bring in stock from suppliers as required. Only the exact number is delivered at a specific time. This not only reduces the impact on working capital, with less liquidity locked up as inventory, but should also improve the efficiency of the whole operations process. This system requires suppliers to have excellent inventory management and delivery systems to send out stock as soon as it is ordered. Sophisticated scheduling software to plan production is used to order the correct stock. EDI is used to share information between suppliers and customers, which helps to ensure mistakes are not made.

The advantages of JIT are:

- reduced costs of storage and securing stock
- increased liquidity of working capital, as less cash is tied up as stock
- reduced chances of stock becoming obsolete and unsellable
- reduced chances of perishable stock spoiling (for example, fresh fruit)

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Source 4.22 A business must have reliable and dependable suppliers who can respond to the business's inventory needs quickly. As the lockdowns were introduced in March 2020, empty shelves became common in supermarkets due to panic buying by customers.

- less warehouse space, allowing more room for other activities
- less time spent on checking products, as without extra work in progress the production process must get it right the first time.

However, as supply is outsourced there is the disadvantage that, if a supplier experiences a problem and stock is not delivered on time, the entire production schedule is disrupted.

Overall, JIT gives a business more flexibility to respond to a changing market and other external influences that can affect sales. However, a business must have reliable and dependable suppliers who can respond to the business's inventory needs quickly.

Review 4.3

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. What is stock loss?
2. Briefly explain how data analytics of marketing information can reduce inventory management costs.
3. Explain one risk of using JIT inventory management.
4. Recommend the most appropriate inventory management system for a restaurant.
5. Assess the importance of holding an appropriate amount of stock.

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4.7 Quality management

Quality can be seen from a number of different perspectives. In terms of marketing, if there is a customer perception of quality there will be increased sales, brand loyalty and the opportunity to charge prices above those of competitors. For a consumer, it can mean that the product provided by a business:

- is reliable and durable
- is free from any defects and safe to use
- provides value for money
- does everything that the advertising claims.

For a customer-focused business, quality also means that each and every good made or provided by the business is consistent in its quality. For service-based businesses, quality can be measured in terms of satisfaction with customer service.

Quality management, therefore, involves all activities that ensure the outputs of the business are consistent, durable and reliable and meet the quality standards stated in the operations plan. In order to remain competitive in today's business environment, a business will aim to produce a quality product or service that provides value for money.

To achieve a competitive advantage over other businesses in the same market, a business may choose as its performance objective to have products of a superior quality. If it cannot achieve superior quality, a business will strive for a certain standard of quality, because inconsistent and poor quality will be an operations cost. Customer returns, poor sales, product recalls and repairs will be significant expenses that will also damage the value of the business.

There are other external influences on quality. The government tries to ensure the quality of all goods through laws that protect consumers from unscrupulous business practices and also protect businesses from one another.

In Australia, products must be fit for the purpose for which they were intended. This means that the product must be able to do what the business claims it can do, and do it safely. This legislation includes the *Competition and Consumer Act 2010* (Cth) and the *Fair Trading Act 1987* (NSW). The government also requires certain businesses that provide services (such as nursing homes and builders) to be licensed or certified.

Licence renewal will require inspections and compliance checks to be completed in order to ensure that certain standards of facilities and care are being maintained.

There are a number of strategies that businesses can use in order to achieve improved quality in both manufacturing goods and the

Business Bite

Businesses are using big data to anticipate and model the influence of variations in demand on inventory and supply chain management. Marketing data for sales and website traffic is combined with information about stock movement, inventory levels, operations processes and employee productivity to efficiently manage operations and meet customer demand. Sophisticated software and cloud-based computing are used to analyse data trends in real time and extract critical business intelligence for faster and more informed business decisions. Big data analysis means patterns and trends can be quickly identified and changes to operations made. Botttlenecks and inefficiency can be removed. Decisions will also impact staffing, warehousing, inventory and cash flow. Businesses are using big data to improve monitoring and control, research and innovation. The data is real-time and enables proactive management of inventory and supply chains to increase profitability. Many smaller firms are outsourcing this function to IT solutions specialists. Some of the largest companies offering data analytics services include Altis Consulting, Analytics8 and IBT (Integrated Business Technologies), all of which are based in Sydney.

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provision of services. The three main approaches to quality management are quality control, quality assurance and quality improvement.

Quality control

It is generally agreed that good management anticipates and prevents problems before they occur. Quality is the responsibility of a specialist quality inspector. For a business that discovers too late that it has been selling poor-quality or defective goods, the consequences will be lost customers, damaged goodwill and expensive warranty costs. A complete recall of products may be necessary and required by the government.

Quality control involves checking transformed and transforming resources in all stages of the production process. These controls can take place at three different stages: feed-forward, concurrent and feedback controls.

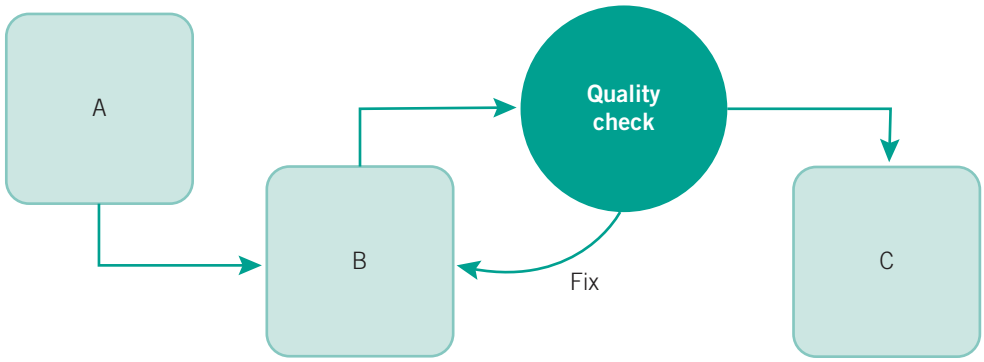
Feed-forward controls involve the use of careful planning before production begins, in order to prevent a problem occurring. Proactive management will anticipate a problem before it arises and amend the situation so that the problem does not occur. An example of a feed-forward control is a fast-food restaurant checking the size of hamburger buns on arrival from the bakery before they go to the production line. Concurrent controls are used during work in progress – that is, during the manufacturing process. This could include a soft drink manufacturer using laser beam technology to determine whether soft drink cans have been filled to the correct level. Feedback controls involve checking the final product – after production or delivery of the service is complete.

Source 4.23 Quality control is necessary to prevent increased expenses and customer loss. This technician is performing quality control on the foil printing of circuitry.

Quality control Checking resources and products in all stages of the production process; includes feed-forward, concurrent and feedback controls.

In some cases, customer surveys are included with the product to try to gauge the degree of customer satisfaction with the product.

Large motor mechanic businesses often contact the client a few days after the client's car has been serviced to thank the client and to gauge customer satisfaction with the service. In each case of quality control, there is heavy reliance on the employees to complete jobs properly.



Source 4.24 Feedback control involves checking quality at a particular step in the manufacturing process, and fixing any quality problems by taking action at an earlier point in the process.

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With the use of batch numbers and codes on products, firms can check where problems exist, determine the production time period involved and identify where improvements need to be made. The problem may arise at the retail end of the distribution chain; for example, inadequate refrigeration in a supermarket may result in food poisoning.

Control involves setting up procedures for evaluation and establishing standards for performance measurement. One of the main reasons for planning an activity is to achieve a particular objective or goal. Once the plan has been put into action, the whole procedure needs to be controlled and monitored. The actual performance of machinery and staff should be measured and compared with what was originally planned. A measure or standard is identified so that results can be compared. A firm may compare its performance to that of other businesses in the same industry by using the industry average as a **benchmark**. This provides a guide to the business's progress. The business will then make necessary corrections or adjustments to its processes in order to achieve the desired results.

Benchmarking The process of measuring performance against established standards, such as a comparison of a firm's performance against standards set by competitors in the same industry in the domestic market.

Effective benchmarking requires a business to:

- identify where quality problems are occurring
- research leading businesses in the industry
- determine the industry standard for quality
- implement changes to achieve the industry benchmark.

Businesses will try to establish why the variations have occurred and will look at both the internal and external influences. Many professional occupation associations have established standards as a control mechanism for the services they provide. These standards are often referred to as codes of practice. They set out the minimum level of service that registered members of a profession are expected to provide. These standards go beyond the rules set by the relevant legislation. Codes of practice have been set up by various professional groups in Australia, including Chartered Accountants Australia and New Zealand, the Law Society and the New South Wales Board of the Medical Board of Australia.

Business Bite

'Clutch power' is the key to the joy of playing with Lego. Quality management must be so precise during production that it ensures each brick is just 'sticky' enough to not fall apart, and not too hard for a child to click apart. Lego uses an intensive global quality management system to ensure every output meets design specifications. Every brick must fit every other toy set and every other brick made since 1958. The company's quality management team uses preventative and quality checks during production as part of its quality assurance strategy. Preventative controls mean that each supplier is responsible for checking the physical and chemical properties of the raw materials they provide. Regular inspections of raw materials also occur. Also to prevent problems there is routine maintenance when specialist technicians clean, check and service every mould. During production, random bricks are selected for intensive measuring and checking. Lego's defect rate is only 12 pieces out of 100 000 made. Finally, Lego developers use a feed-forward control focusing on foreseeable misuse to ensure that no Lego product can be harmful when children are playing with it. This control ensures compliance with government consumer protection legislation in every country where Lego is sold. Thus, it does not matter if a brick is moulded in Denmark, Hungary or Mexico; it will have the same properties. The global quality management system is implemented by all Lego employees. Training occurs in different parts of the world, but standardised equipment and systems mean that a member of the quality control team can work in any of Lego's factories.

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Ethical Spotlight 4.1

Some businesses may ignore potential problems with their products. Their research may have told them that the cost of the recall may be a lot more than the cost of legal action. Do businesses have an ethical responsibility to recall their products if they only think there may be a problem and no actual fault has been reported?

Quality assurance

While quality control involves measuring quality and taking corrective action, quality assurance is much more proactive; that is, it aims to prevent quality problems before they occur. **Quality assurance** involves establishing and using a set of procedures and processes that will prevent product defects or errors in delivering services from occurring. Quality is 'assured', or guaranteed, because the whole business is focused on ensuring quality. There is more emphasis on the contribution to quality from the whole operations system and the entire business. Employee involvement through **quality circles** and work teams has been an effective strategy to identify and discuss quality issues, prevent development of defects and solutions to quality issues.

Quality can be guaranteed by achieving certificates for meeting quality standards from Standards Australia and AS/NZS for Australian and New Zealand Standards, and ISO (International Organization for Standardization) certification for meeting international standards. Examples of these certificates are:

- AS/NZS ISO 9001 or 9002 and 9003 – the business has satisfied these requirements and is recognised as a 'Quality Endorsed Company'
- 9001 – indicates that the business has quality assurance in product design, development, manufacture, installation and servicing
- 9002 – indicates quality assurance in manufacturing
- 9003 – covers service-based industries.

Possession of a 'Quality Endorsed Company' certificate provides assurance that a quality management system is used in operations. The other advantage of obtaining a quality assurance certificate is that many businesses and government organisations prefer to deal with businesses with proven quality systems.

Video 4.1 ISO standards

Quality improvement

The **total quality management (TQM)** approach to quality relies on continuous improvement in all functional areas, not just operations. It is often referred to as *kaizen* and is widely used in Japanese industry. Rather than correcting mistakes, controls are put in place to ensure poor-quality goods never reach the consumer. The greatest success would come from getting the process right the first time (that is, zero defects as a performance objective).

The concept of quality circles is relevant to TQM. Quality circles are regular meetings of a group of employees from different sections of the business to discuss issues arising in the workplace, even if there are no current quality issues. For example, a meeting of all staff can be called each morning to review the key performance indicators (KPIs) of the previous day's operations. Employees are encouraged to discuss quality issues and offer suggestions. There is a focus on continuous small improvements in products and processes. It is a much more effective strategy than waiting for major improvements from technological breakthroughs. The group tries to clearly identify any problem areas and come up with possible solutions to those problems. The team leader presents their results to management for consideration, and they then make the final decision about the actions to take. TQM necessitates careful review of the actions of competitors and possible innovative measures to be taken in relation to all aspects of the business.

Quality assurance Establishing and using a set of procedures and/or processes that will prevent products from having problems (such as faults or errors).

Quality circles Regular meetings of a group of employees from different sections of the business to discuss issues arising in the workplace.

Total quality management (TQM) An approach to quality control that relies on continuous improvement in all aspects of the business. It is often referred to as *kaizen* and is very evident in Japanese manufacturers, such as Toyota.

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Through benchmarking, many businesses are able to compare themselves with the rest of their industry. This allows a firm to identify critical processes that may need improvement. The firm will then study the best operational processes used by its competitors in order to select ways that the firm can improve its own methods. Through **world's best practice** the firm can compare its productivity or performance with the highest standards achieved by businesses worldwide and select businesses to use as models.

World's best practice Comparison of a firm's performance with the highest standards achieved worldwide.

Improvements in quality can be measured using KPIs. These will vary from industry to industry and are often based on industry benchmarks of what is commonly accepted in Australia (or internationally) as the standard a business should aim for. A business may even compare itself to its largest competitor. Examples of KPIs include:

- number of defects per 100 units manufactured
- number of warranty claims made by customers
- percentage of repeat customers
- number of accidents and operational incidents
- repair costs
- number of working hours lost due to breakdowns or interruptions to operations
- amount of positive customer feedback from surveys.

With improved quality a business will experience reduced operations costs, higher sales and repeat customers, and hence more profit. However, it can be very costly to ensure quality; staff may need retraining, and it can take considerable time and effort to change the corporate culture to being quality-focused.

Source 4.25 Comparison of quality control with quality assurance

Quality control	Quality assurance
Usually at the end of operations, one person reviews the products made and checks for mistakes. Checks during the operations process may also be done.	Systems, procedures and policies are in place to prevent quality problems. No one individual is responsible for quality; everyone has a contributing role, no matter how small.
A certain percentage of defects is allowed and set as a standard.	Quality is assured, as all products are expected to pass inspection; zero defects.
Assembly lines flow continuously unless repairs are required.	Production process can be interrupted to improve systems.
Quality management stops once the product leaves the business.	Quality is provided through after-sales service.
Employees are not included in quality improvement decision-making.	Employees are included in decision-making through quality circles, consultation and two-way communication.

Review 4.4

Discussion

Answer these questions on paper or in the Interactive Textbook.

1. Describe an appropriate strategy that could have been used to prevent a quality issue.
2. Briefly explain how a business will use quality benchmarking.
3. Analyse the impact of a voluntary recall on the business.
4. A manufacturer of kitchen appliances has a website that customers can use if they have a problem with any of its products. The business has learned from customer complaints that a failure in quality control could lead to a fault in a small number of its products, causing them to turn off without warning. The company has decided to voluntarily recall all its products. Evaluate the business's quality management strategy and recommend a quality strategy to prevent this problem.

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4.8 Overcoming resistance to change

Resistance to change was discussed in the Preliminary course; however, it is worth revisiting as businesses are changing in response to the external environment, globalisation and the need to maintain a competitive advantage through operations. Kurt Lewin was an American social psychologist and is regarded as one of the founders of modern psychology. He is perhaps best known for developing Force Field Analysis.

Lewin's Force Field Analysis identified that a business has driving forces and restraining forces. **Driving forces** are those that push towards the need for change. **Restraining forces** are those that hold the business back and resist any change that is attempted. The challenge for management is to identify and develop strategies to overcome the resisting forces. In operations, the resisting forces will be related to costs and inertia. Costs may be associated with purchasing new equipment, redundancy payments for employees replaced by equipment or technology, retraining costs to operate new equipment and technology, and reorganisation costs associated with changing the layout of the plant, factory or office.

There is also resistance owing to inertia, as people in the business can react emotionally to change and, rather than embrace the challenges and opportunities it offers, merely wish for things to remain as they are.

Purchasing new equipment

Management needs to be aware of technological change and assess its application to the business. Not all technological developments or equipment are appropriate for implementation at the business. Managers must assess the cost of the installation of the equipment, its impact on production and the expected profitability generated by the change. There will be long-term impacts on the financial position of the business, often because new equipment and technology may need to be funded from debt finance. Therefore, there may be financial resistance to changing technology in the business. Purchasing new equipment is an internal influence, because managers decide how to use it in the business. Several technological changes may not be simple to implement but may result in a long-term reduction in operating costs, decreased time delays in communication and faster decision-making processes. Old equipment may still have a value and may be sold to create space for new equipment.

Ultimately, the operations manager must consider all the costs associated with purchasing new equipment and weigh up the long-term cost savings against the short-term impact on the business.

Redundancy payments

Driving force A force that pushes towards the need for change.

Restraining force A force that holds back a business and resists change.

An employee redundancy occurs when an employee is no longer required because their job no longer exists or they have been replaced by new technology or equipment. Their role may have become automated and they are unable to find a position in another area of the business. In Australia, redundancy payments are legally required in the following circumstances:

- There is an award or enterprise agreement covering redundancy pay.
- The business is not a small business, having more than 15 employees.
- The employee has worked full-time and has worked continuously for 12 months or more.

From 1 January 2010, the National Employment Standards stated the redundancy entitlement of employees based on their base rate of pay, shown in source 4.26.

If a large number of long-time serving employees are made redundant by changes to the business operations, then redundancy payments represent a significant cost of implementing change.

Source 4.26 Employee redundancy entitlements

Number of years of service	Redundancy pay of
1–2 years	4 weeks
2–3 years	6 weeks
3–4 years	7 weeks
Maximum payment	
9–10 years	16 weeks

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Retraining

Labour is often considered to be a business's most valuable asset. When changes are made to the business, another cost consideration is the cost of retraining staff so that they are productive, and work efficiently and effectively. Even when retraining is successful, there will still be a period of adjustment as employees improve their familiarity with new equipment, new technology or changes in systems and procedures. It may take an extended period before employees are back to the productivity levels they had prior to any changes. These are the more hidden costs of change.

Without adequate training, the benefits of new equipment, technology or new processes will not be fully realised. The implementation of comprehensive training programs can go a long way to overcoming employee resistance to changes.

Source 4.27 Even when retraining is successful, there will still be a period of adjustment.

Reorganising plant layout

With the acquisition of new equipment and technology at a factory or business, there may need to be a reorganisation in the way equipment is placed so that manufacturing occurs in the most efficient manner and bottlenecks are avoided. A business may change from a process layout using assembly lines to a product layout where the product remains in a fixed spot and all the inputs and components converge at a central location for final assembly. The plant layout may have to change to manage more product variety or volume. Significant changes will occur to the layout if the business moves from a highly repetitive operation to one that uses batches or individual jobs to make products for customer orders.

Other examples could be reorganisation of displays in a shop to achieve a better flow of customers through the store or changing the layout of the dining room and kitchen in a restaurant to fit in more tables and prevent congestion as staff move around serving customers.

The costs of reorganising can be a disincentive to change, as it can require halting production while equipment is physically moved. The larger the equipment and more complicated the plant layout, the longer it will take to restart operations and generate sales again.

Inertia

There can also be resistance to change owing to inertia. Internal stakeholders such as owners, managers and employees can become comfortable in a stable environment, as there is a feeling of security and predictability. Change can create uncertainty and risk, and therefore employees may resist it due to fear of deskilling, job loss, higher workloads and loss of their familiar work environment. Owners and managers may also have fears about the financial future of the business and whether change will enable the business to be more competitive. If the business has had a history of 'change for change's sake' or has failed to capitalise on previous changes, then inertia will be a greater resisting force.

Operations management has to identify as many forces for change as possible and use its skills of effective management to create a positive culture for change. There needs to be an understanding of the driving forces. Globalisation, technology, demographics, social attitudes, the law, economic growth and competitors are all external drivers of change. Internal sources can occur with new products because when they are developed there may be changes in the way the business's production is organised. A possibility of increased automation drives change in the business. Managers need to motivate and communicate with staff, encourage participative decision-making, provide training

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and counselling, negotiate, possibly manipulate or even coerce. Strategies that management may use to overcome resistance to change could include retraining programs, work teams and a flatter organisational structure.

Source 4.28 The driving forces for change must outweigh the resisting forces.

Review 4.5

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Define the term 'inertia' when it is used to describe forces resistant to change. Refer to an example in your answer.
2. Outline a potential benefit to marketing when a business changes operations.
3. Provide two reasons why an operations manager would be resistant to investing in new equipment.

4.9 Global factors

Globalisation can present many cost-saving opportunities for managers if they choose to expand operations. Global factors are another external influence on business and must be managed to reduce the additional risks of operating in a global business environment.

Operations strategies need to be able to respond as the international business environment changes. Global factors that can influence business operations are the opportunities to obtain inputs from cheaper sources overseas, to expand and achieve economies of scale, and to develop new products for an international market.

Global sourcing

Global sourcing was discussed earlier in this chapter under 'Supply chain management'. A benefit of globalisation is the opportunity for businesses to acquire inputs from other countries or a low-cost region (LCR) in order to reduce overall costs. However, just purchasing from a low-cost source does not guarantee low total costs. There are additional influences from the global environment in setting up a system of sourcing inputs from overseas sources, including:

- the need to invest considerably in searching for and researching suppliers as well as time to build up relationships with suppliers
- lack of experience in international transactions
- language and cultural barriers
- increased lead times
- less control over the quality and reliability of inputs
- the possibility that competitors may use the same supplier.

Therefore, it is recommended that businesses manage these risks by outsourcing to experts in the field of global sourcing solutions.

A **global web strategy** involves a business sourcing inputs from the cheapest regions, manufacturing where it is cheapest to do so, obtaining finance from the country with the lowest interest rates and distributing products to any nation that demands them.

Global web strategy Involves a business sourcing inputs from the cheapest regions, manufacturing where it is cheapest to do so, obtaining finance from the country with the lowest interest rates and distributing products to any nation that demands them.

There is an intricate web of subsidiaries around the world, all linked by transactions and the movement of goods. A global business using a global web strategy will not be able to function if a subsidiary cannot fulfil its role. A key type of global web strategy is one in which a global business has each input made in the country that can make inputs at the best quality and at the lowest price. Some inputs need low labour costs, while others need a certain level of technology. These resources are only available in certain parts of the world. An input may be quite rare and only available at an affordable price from a particular place. A global business using a global web strategy will most likely locate its financial headquarters in a developed country (such as the United States), source its inputs from around the world, produce in the country with the cheapest labour costs and export to its global market. With this strategy, coordinating the delivery of each input is very difficult and has to

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Source 4.29 A global web strategy might bring together diverse role players.

be scheduled efficiently to reduce costs. Inputs may be delivered too early (increasing storage costs) or too late (delaying production), or not be delivered at all.

Economies of scale

Developing economies of scale is a strategy to reduce production costs by increasing in size. The larger the size of the business, the more the actual cost of making each individual product decreases. Through global expansion, a business can achieve production economies of scale by having larger manufacturing facilities, moving closer to raw materials and labour or delivering services to a larger market. By increasing in size, the business spreads its costs over more units. The average cost of making or supplying each unit will fall. Other costs can be reduced; for example, a large business can obtain discounts for large orders of inputs and the actual process of operations may flow more efficiently.

Bigger can mean cheaper, but only up to a certain point. Diseconomies of scale will occur, causing costs to rise. Inefficiencies are caused by overly complex operations and loss of direction and control by operations managers. In very large, geographically dispersed organisations, even with instant communication over the internet, decision-making can slow down as more people are involved, considering more variables that influence operations.

An option to achieve some of the advantages of economies of scale is to have a joint venture or strategic alliance with a business in the same industry. An Australian manufacturer may join with a foreign-based supplier and manufacturer to give both businesses advantages of economies of scale.

Activity 4.4
Comprehension

1 Define 'global web strategy'.
2 Explain the types of businesses that a global web strategy offers the most advantages to.
3 Research a business with a global web of operations and describe how it uses this strategy to achieve a competitive advantage.
4 A business has decided that it will not have a research and development department. Analyse the impact of this decision.

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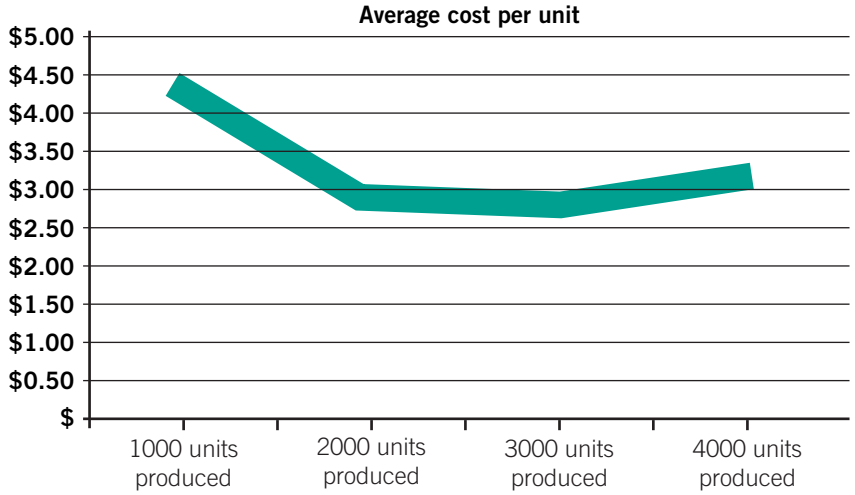

Source 4.30 In this example, economies of scale worked extremely well for 1000 to 2000 units, and slightly for 2000 to 3000, but after this there were diseconomies of scale. The graph does not show the reason, but it might be that producing quantities at this level led to overly complex operations with higher risk of errors.

Scanning and learning

Globalisation means that operations managers have the opportunity to scan the global environment to identify and learn about the critical global trends that may impact on their business. These trends apply to both the macroeconomic environment and the specific industry the business operates in. By continuously monitoring the global environment, managers have an informed basis for making strategic business planning decisions with respect to operations. Businesses must be aware of developments and changes in:

- the global demand for their goods and services – what parts of the world have a growing market and what areas are shrinking
- supplies of transformed and transforming resources – whether new lower-cost sources are available
- new manufacturing processes that are available
- the emergence of new competitors as a potential threat
- new products and services that the business could invest in
- labour and environmental protection laws
- nations with policies to attract global businesses, such as offering low-cost energy and infrastructure.

For example, China has been viewed as a cheap manufacturing location. However, recent studies show that Shanghai has become a more expensive place to do business and better opportunities now exist in two neighbouring provinces, Zhejiang and Jiangsu, which border China's commercial centre. Production can be shifted to these cheaper regions. Of particular relevance to operations managers, changes to the suppliers of materials will need to be monitored and assessed. Changes in things such as quality, quantity, price and potential delivery delays will be significant.

A business may also learn about a technological innovation or a new product that may be applicable to its industry. Even if the business does not have the resources to develop its own innovations, it can imitate innovations by detecting and learning about developments of its competitors or overseas. The business can closely follow with its own version of the new product, and thus maintain its competitive advantage.

Research and development

Research and development (R&D) is an innovation strategy for the creation of new products and the improvement of existing ones. Innovation is crucial to the long-term survival of any business. A business cannot stand still once it has launched a product. The product will eventually reach the end of its life cycle as it

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becomes obsolete and competitors release new products. R&D can extend the product life cycle, take the business in a new direction or enable new products to be created. The process for the development of new products is discussed in further detail in Section 4.2 'New product or service design and development'.

Business Bite

How can a pencil change the world? Graphene is derived from graphite used to make the lead in ordinary pencils. It has a crystalline structure that can be cut to the thickness of 1 atom. This makes graphene the thinnest material in the world. Two researchers from the University of Manchester, Andre Geim and Konstantin (Kostya) Novoselov, worked out how to create graphene when they were playing around in their lab one Friday night to see who could make the thinnest layer of graphite using sticky tape. Graphene has many potential applications in electronics, medicine and energy. Various technology companies have been researching how graphene can be used to develop foldable touch screens, for example. Samsung was the first major brand to release a foldable phone, using the innovation to gain an advantage over its rivals. However, quality issues were experienced early, as the technology did not perform as well as claimed. Samsung created a plastic film to protect the polymer screen with a new process and adhesives so that the screen could withstand bending and flexing without breaking. Some reviewers claim that the product was rushed through the technical filter and not fully tested. The plastic peeled and phone screens turned black. Samsung delayed its release of the Galaxy Fold as a result. Foldable phones may create an entire product category of mobile computing.

Source 4.31 The Samsung Galaxy Fold

Despite the financial risk of investment, R&D can have significant advantages for a business. It can:

- extend the product life cycle
- open up new markets internationally
- give the business a reputation as a leading innovator
- lead to improvements in quality
- reduce costs
- motivate the workforce
- provide opportunities to develop other new products.

However, there may be several issues and problems created by this innovation strategy:

- It may send the business in a direction away from its prime function.
- It can consume valuable financial resources that do not provide a return for years.

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- There is an opportunity cost of what other projects the money could be spent on, such as more marketing.
- It can be wasteful, as many suggested projects never make it to market.
- There may be ethical issues involved.
- The business must have the technical ability and equipment to build the product or deliver the service.

Innovation is not limited to products. Process innovation involves the development of the operations function itself to bring benefits to the business. New technology or JIT inventory management may be introduced, or an innovation in the production method itself may be developed.

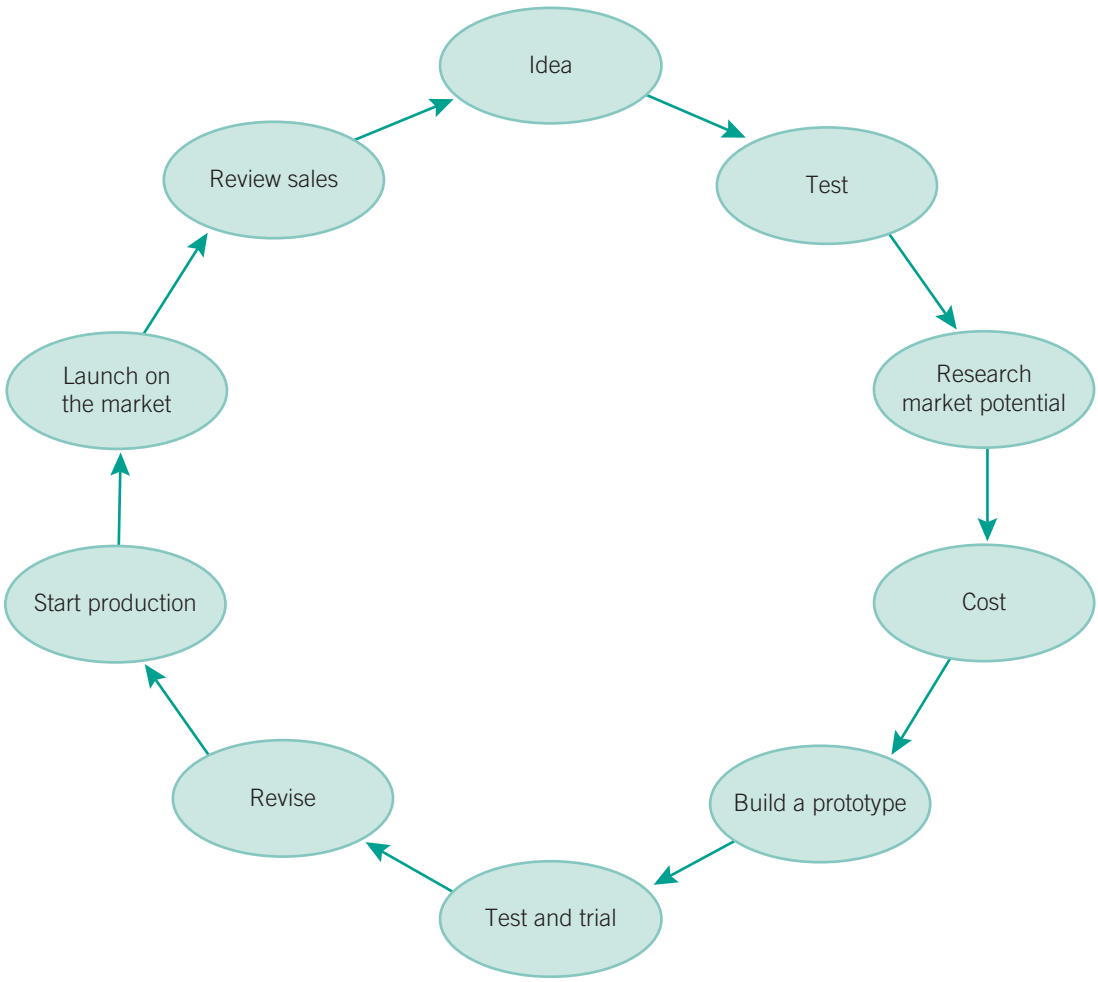
New ideas are sometimes referred to as intellectual property. Any business that invents a new product or innovation needs to protect its intellectual property. A standard Australian **patent** gives an individual or business 20 years' protection from any organisation copying its new idea. The business has a 'first mover' advantage in the market. This head start can give a business a dominant market share and the name of the product can become the generic name used for the product, such as Band-Aid or iPod.

Patent Gives the owner the exclusive rights to sell, market, license or make a profit from an invention, innovation or production technique.

There are limits on R&D, mainly because it is such a long-term, high-risk strategy. Other constraints on innovation include the cost and availability of new technology, employee expertise, pressure from shareholders to avoid risk, a lack of competition in the market and resistance to change. Given these issues, businesses should still invest in some research and development in order to make changes to improve the operations process, reduce costs and improve quality.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 4.32 Summary of the R&D process



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Chapter summary

The decisions of the operations manager about the strategies used will have a major impact on the cost of producing goods and delivering services, how well they are produced and delivered, and their quality. Effective and efficient operations management reduces costs, increases revenue and improves profit.

Operations strategies are the objectives, plans and methods used to give the business a competitive advantage and determine how this advantage will be sustained.

Performance objectives for operations strategies are quality, high speed, dependability, flexibility in production and service delivery, opportunity for customisation and low costs.

Innovation is not limited to products. Process innovation involves the development of the operations function itself to bring benefits to the business.

Supply chain management aims to reduce inventory costs, reduce waste, enable faster delivery to markets and thereby have more satisfied customers.

Holding buffer stock has the advantage of meeting unexpected increases in demand; however, there are higher costs and a greater risk of spoilage or stock becoming obsolete.

Quality management is a three-stage process. First, quality controls are established. Second, the business aims to establish a set of procedures and/or processes that will prevent problems or errors in delivering services occurring through quality assurance. Finally, quality is improved through a total quality management approach.

Overcoming resistance to change in operations requires strategies and management skills to emphasise the long-term contribution to lower costs and better quality. Resisting forces are related to costs of changing operations and to the personal inertia of owners, managers and, in particular, employees.

Global factors that can influence business operations are the opportunity to source inputs from cheaper sources overseas, the opportunity to expand and achieve economies of scale, and the development of new products for an international market.

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End-of-chapter tasks

Chapter revision task

Place the correct term against each statement.

Transport logistics	Robotics	Quality assurance
Stocktake	Benchmarking	Stock-out
Codes of practice	Wholesaler	Quality circles
Break-even point	World's best practice	Driving force
Intermediate good	Vertically integrate	Supply chain

1 Used by other businesses in the next stage of manufacturing as an input for further processing.

2 The development of programmable devices built to complete repetitive tasks.

3 Obtains goods in bulk from lots of suppliers and then makes these goods available in smaller quantities, most often to retailers.

4 When a business purchases a controlling interest in other businesses in its supply chain.

5 Levels of conduct that registered professionals adhere to that go beyond the rules set by legislation.

6 Physical counting of inventory or stock.

7 A force that pushes towards the need for change.

8 Purchasing system used by a firm.

9 Establishing a set of procedures to follow to prevent products from having problems.

10 Measuring a business's performance against that of the rest of the industry operating in the domestic market.

11 Used for comparing a business's performance with the highest standards achieved worldwide.

12 Regular meetings of employees from different sections of the business to discuss issues arising in the workplace.

13 A situation in which a business runs out of inventory.

14 When total revenue from sales equals total costs of operations.

15 The organisation of the physical movement of inputs and outputs from their point of origin to their destination.

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Multiple-choice questions

1 Which inventory control system would minimise warehousing costs?

A Bulk purchasing
B Just-in-time
C Just-for-now
D Longest lead time

2 Which of the following best defines operations strategy?

A How the business will employ its production capabilities to reach its strategic operations objectives
B How a business makes goods and supplies services
C How a business uses market research to produce goods that customers desire
D The amount of capital or labour used to produce

3 What is the correct order for quality management?

A Feedback controls, concurrent controls, feed-forward controls
B Feed-forward controls, concurrent controls, feedback controls
C Employee consultation, quality circles, quality implementation
D Analysis, measurement, prevention

4 How can a business protect the unique manufacturing method it has invented?

A By using a recognisable logo
B By licensing its products
C By registering the business
D By obtaining a patent

5 Which business would use the FIFO system of inventory management?

A A car dealership
B An insurance business
C An electronics retailer
D A mining company

6 The research and development manager of a gaming company has purchased a competitor's game console and controls in order to discover how its rival manufactures its products.

What operations strategy is this an example of?

A Change management
B Quality management
C Scanning and learning
D Research and development

7 What is an advantage of large-scale operations?

A Greater efficiency in production
B Low costs for the supply of inputs
C Higher average costs
D Access to a larger global market

8 A biscuit manufacturer is able to make each biscuit for a lower average cost when it increases the speed and output of its factory.

What is this an example of?

A Breaking even
B Change management
C Economies of scale
D Inventory management

9 Which of the following are financial costs to a business of implementing change?

A Retraining staff and redundancies
B Personal inertia of employees
C Inertia from managers
D The cost of purchasing a supplier

10 Which of the following identifies disadvantages of outsourcing?

A Access to specialist knowledge and expertise, which can be expensive
B Shorter lead times, increased speed and quality of outputs
C Loss of control over quality, reliability and even costs
D A possibility that two businesses share the same supplier

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Short-answer questions

1 What is supply chain management?

2 Explain how a business can gain a competitive advantage with an operations strategy. Illustrate your answer with an example.

3 Briefly explain one benefit of vertical integration.

4 A company manufacturing gaming computers in Vietnam has decided to outsource the development of a new high-speed processing chip to a Korean company. The company hopes a faster processor will give its products a competitive advantage.

Analyse the company's decision to outsource.

5 Assess the use of technology to improve the operations of service-based businesses.

6 'Inventory management can be as much an art as a science.' Discuss.

Extended-response question

Outline the methods of quality management and explain its role in operations management.

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TOPIC 2
Marketing

25% of indicative time

Principal focus

This topic focuses on how marketing strategies are developed and implemented successfully.

Introduction

Video 5.1 Introducing Topic 2 Marketing

Marketing is the most recognised of all business operations. It is through the process of marketing that a business is able to develop a product and then implement a series of strategies aimed at encouraging a particular group of customers to buy the product. These activities must be implemented within a legal framework seeking to protect key stakeholders in the marketing process, such as consumers, business and the environment.

Marketing allows a business to communicate with its customer base. This process involves determining the features of a product, the types of promotional strategies to use and how customers will be able to purchase the product. This is done through market research, whereby a business is able to find out the needs of its consumers, their tastes and preferences and how much they would be willing to spend on a particular product.

A successful business is often one that is able to develop a long-term and valued relationship with its customers. Businesses recognise that not all customers are the same. People seek different products and services at different prices. It is important, therefore, that a business understands who its customers are. It should examine why particular groups buy the business's products and whether its marketing strategies are effective in developing customer awareness and sales. It is through the process of marketing that all such activities are achieved.

Outcomes

Students will:

- analyse critically the role played by business within Australia and internationally
- evaluate how internal and external changes can influence management strategies
- discuss management's responsibilities regarding social and ethical matters
- analyse how large and global organisations use processes and functions
- explain the impact management strategies have on businesses
- evaluate how a business's performance is impacted by effective management
- investigate current issues affecting businesses
- organise and evaluate information about real and potential situations affecting businesses
- communicate, using effective formats, details of business information, issues and concepts
- apply appropriate mathematical concepts to a study of business situations.

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Content

Students will learn about the role, influences, processes and strategies of marketing, through examination of current business issues, and investigation of real and potential business situations.

By the end of this topic

Students will have learned to:

- explain the central role played by goods/services in operations and marketing
- examine the importance of ethical behaviour to marketing
- assess whether the marketing of goods and services is most effective when a variety of promotional strategies are used
- evaluate the strategies used by a business to market a good or service
- analyse a business's marketing plan
- explain the impact globalisation has had on the management of marketing.

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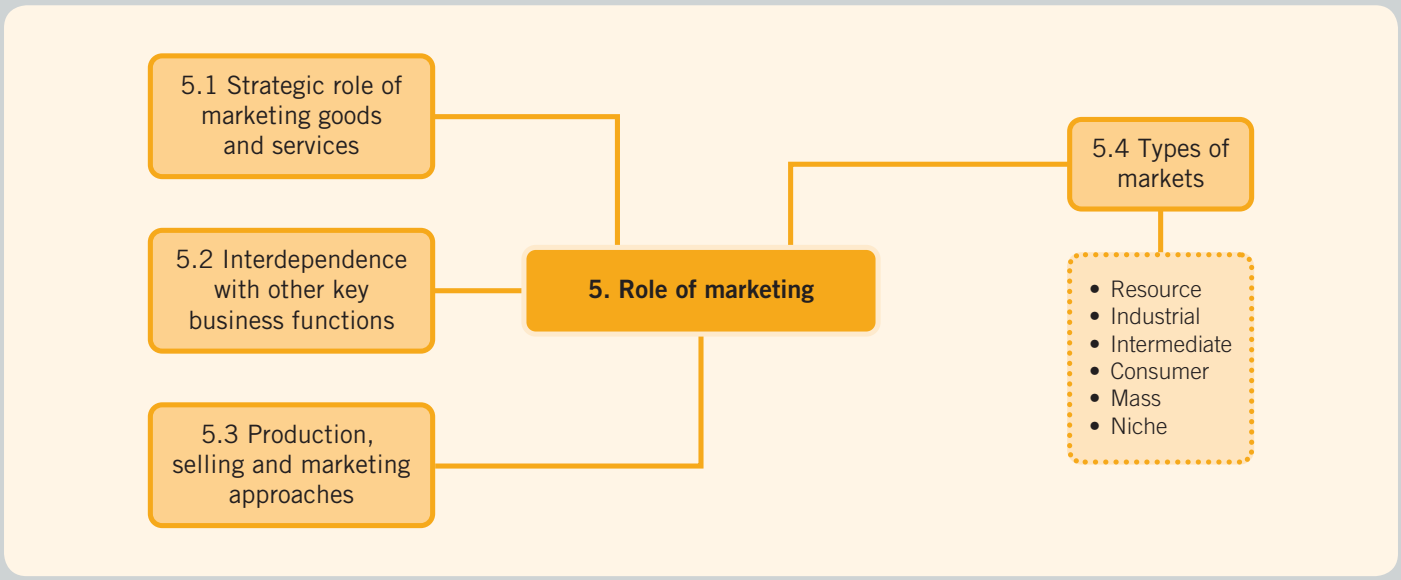
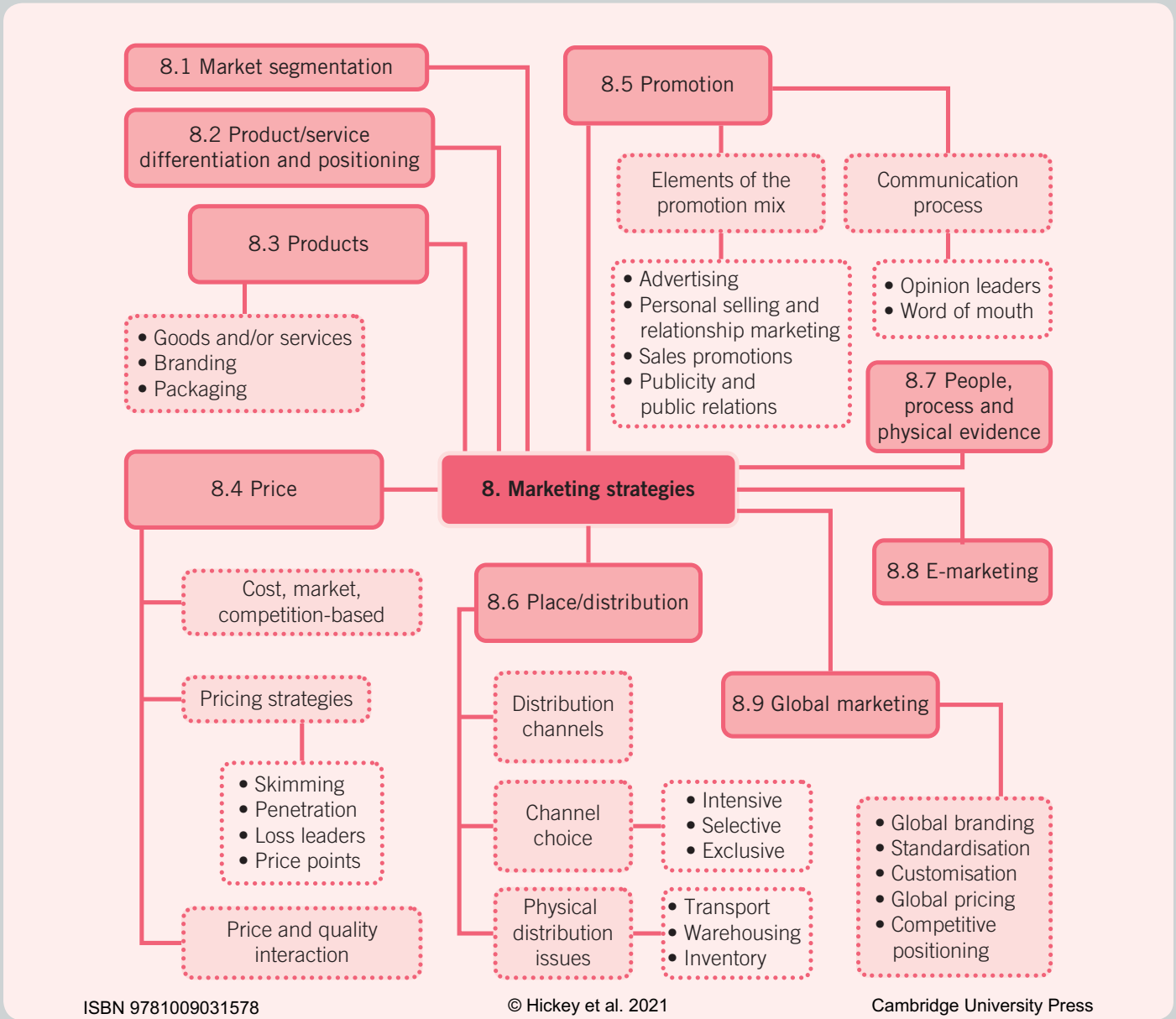
Marketing





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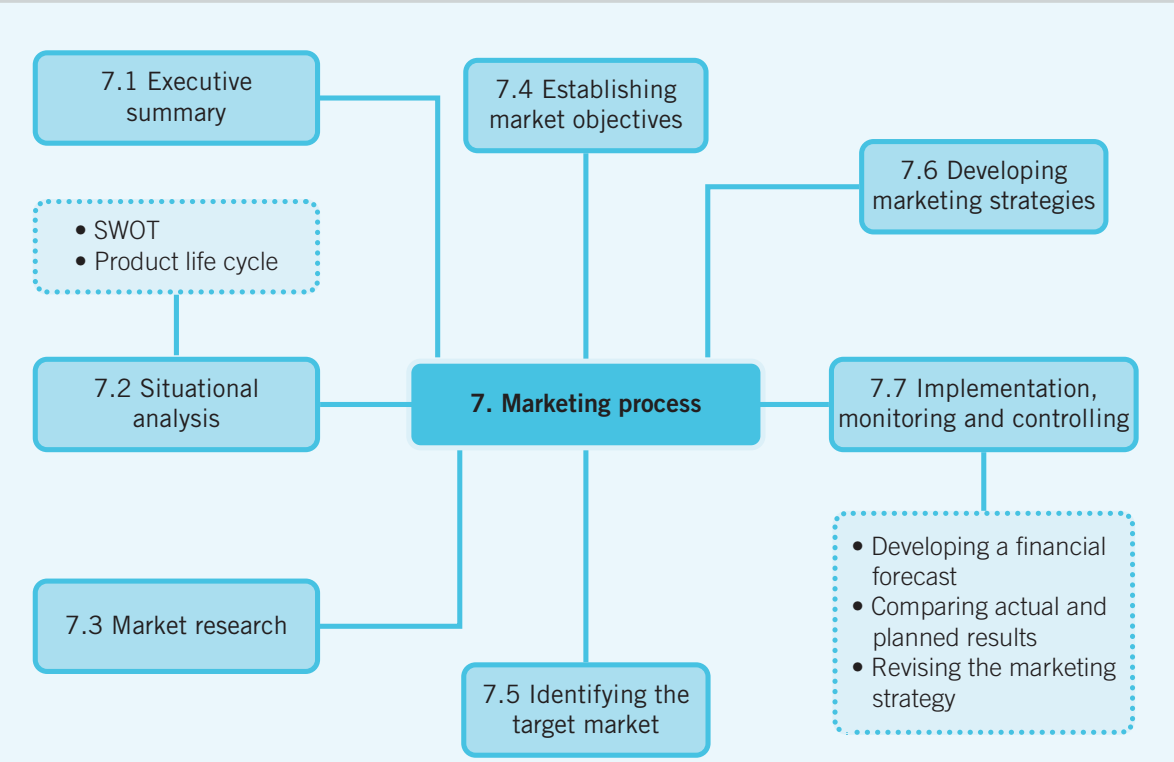

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5 Role of marketing

Chapter objectives

In this chapter, students will:

- investigate the strategic role of marketing
- analyse the interdependence between marketing and the other business functions
- evaluate different types of markets.

Key terms

- brand awareness
- employment relations function
- finance function
- human resource function
- industrial markets
- intermediate markets
- market share
- marketing
- marketing function
- marketing mix
- mass market
- niche market
- operations function
- resource markets
- selling approach
- standard of living
- strategic role of marketing

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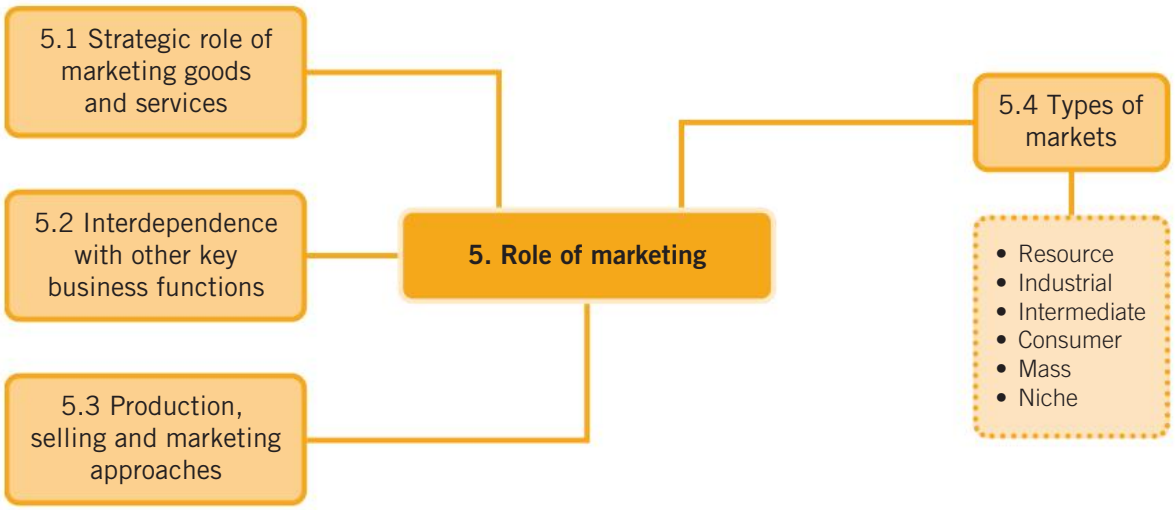
5.0 Introduction



Source 5.1 Role of marketing

Marketing is the process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers. More than any other business function, it is the role of marketing to develop and implement strategies that generate revenue and sales for the business. While other functions may finance and produce the good or service, it is the responsibility of marketing to sell it. Marketing involves researching the changing nature of consumers' tastes and preferences: what they like and what they don't like. The purpose of this is to determine what the business should be producing.

Marketing also involves the development of products to provide consumers with an improved **standard of living** and greater choice within the marketplace. Marketing is also concerned with determining a price that is consistent with consumers' expectations and reflects the desired image of the product or business.

Marketing should consider the impact that price will have on the perceived quality of the product and the ability of that price to sustain market share against its competitors.

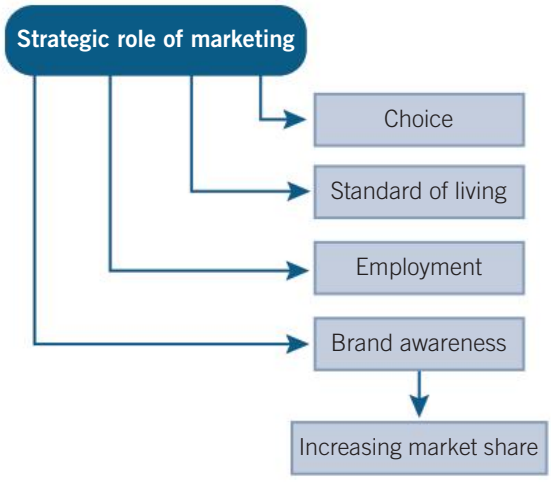
5.1 Strategic role of marketing goods and services

Marketing is used primarily by a business as a method of enhancing its revenue streams and increasing the market's awareness of its products. The **strategic role of marketing** is to allow the business every opportunity to maximise its scale and profits. It also extends beyond the business itself, and its influence is shown clearly through its impact on society.

Marketing The process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers.

Standard of living A measure of an individual's quality of life, partly based on what goods and services the individual can afford to buy.

Strategic role of marketing The ability of the business to develop goods and services that develop a long-term relationship with a specific customer base and, in so doing, generate sales and revenue for the organisation.



Source 5.2 The strategic role of marketing

Digital quiz
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Choice

An important feature of any business environment is competition. Businesses compete to attract customers to purchase their products. To do this, they must differentiate their products from similar products in the marketplace; otherwise, consumers would perceive the products to be the same. Differentiation is the process of doing things in a different way from a competitor. In doing this, the business must consider how to make its product or service different. This could include developing new product features, pricing strategies or promotional activities. This concept is known as a competitive advantage.

Competitive advantage refers to those features of a product or business that provide it with an advantage over its competitors. It could include price, product quality and reputation or consumer loyalty. It is what enables a business to attract consumers to the business or its products in preference to a competitor. Marketing provides consumers with choice. What may act as a competitive advantage for one business and its customers may be different for another. For example, Ikea is regarded as a market leader in the global homeware industry, selling ready-to-assemble furniture, storage solutions and home appliances. Ikea has developed a reputation of providing a wide range of quality products at affordable prices. Consumers are able to customise many of Ikea's product offerings, providing choice to market segments that demand the flexibility to design their own kitchens, lounge chairs and wardrobes. This value proposition provides the business with a point of differentiation from competitors such as Amart and Fantastic Furniture, which deliver more standardised solutions.

Standard of living

To ensure that businesses are providing consumers with goods that appeal to the needs of society, organisations develop and market products that are aimed at enhancing our lifestyles. To provide consumers with better products and, more importantly, allow businesses to develop their income streams, businesses are constantly improving the features of their products. In the early 1980s, consumers would not have imagined that telephones would be pocket-sized, mobile and have internet access, or that computers would be hand-held and that people would talk to one another using a computer rather than a fixed-line telephone.

Through the variety of products and services provided by business, the quality of life for Australians has improved. Research and development has also played an important role in improving quality of life. Businesses spend millions of dollars each year developing products that will help consumers to adopt and maintain a healthy lifestyle. Supermarkets such as Coles and Woolworths have now developed a range of ready-to-make meal kits to cater to the increased dietary requirements of the ever-growing health-conscious market segments.

Business Bite

Source 5.3 Businesses must provide consumers with products that increase their standard of living.

On your next visit to the supermarket, pay close attention to all the new types of ice cream being produced. As consumers have become more health-conscious, many businesses have responded by developing low-calorie and dairy-free ice cream. Halo Top is a prominent ice-cream manufacturer that produces flavours such as Peanut Butter Cup, Cookies and Cream and Mint Chip – all of which contain less than 320 calories per tub.

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Employment

Often when the term 'marketing' is discussed, people associate it with publicity, pricing and advertising gimmicks. It is important to remember that marketing would not exist without a product or service to sell. To provide a product to consumers, a business must employ labour to assist in the transformation process of changing input resources into finished goods. It must use the skills of this labour to research innovative methods of improving and enhancing the product. Some people are required to sell the product. Marketing, therefore, provides a source of income and employment for millions of Australians each year. It is with this income that they are able to purchase the goods and services that satisfy their needs and wants.

Brand awareness

A fundamental goal of any marketing campaign is to increase a brand's visibility within the commercial environment. Strong brand awareness allows a product to remain in the minds of consumers. This, in turn, is likely to influence the consumer's purchasing decision. Successful businesses are often those that have high brand awareness among consumers.

Brand awareness is often achieved through strong and effective marketing campaigns. Businesses also make use of electronic and print media to publicise their products.

Ethical Spotlight 5.1

If major businesses are attempting to improve the quality of life of consumers, why does organic food cost more?

Increasing market share

Market share refers to the percentage of total sales a business has compared with its competitors in a particular market. The purpose of attempting to increase the market share of a business is to increase the business's sales and profitability.

Achieving this objective allows the business to become stronger and more consumer-aware in the marketplace. Woolworths has effectively maintained the 'Fresh Food People' slogan to promote an image to consumers that it wants to be known as the seller of fresh food products. The term 'fresh' promotes an image of quality.

Brand awareness The extent to which consumers recognise the existence of a particular product, its features, price and possible places of purchase.

Market share The percentage of total sales a business has compared with its competitors within a particular market.

Source 5.4 Disney is one of the most recognisable brands in the world.

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Business Bite

In the expanding active wear market, Australian company Echt has rapidly increased its market share, now servicing customers in over 50 countries worldwide. Much of Echt's success can be attributed to its innovative designs and 'on trend' range of fitness clothing. Echt, meaning authentic in German, collaborates with many fashion influencers to develop a strong social media presence. IBISWorld predicts that the size of the fitness and clothing market will reach $2.8 billion in 2021.

Review 5.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Outline how businesses can achieve the strategic role of marketing.
2 Explain how increasing market share may lead to the achievement of a business's goals.

5.2 Interdependence with other key business functions

A successful business incorporates many features. These would include strong profitability, good brand awareness and high employee satisfaction. Given this, a successful business is also one in which the internal components of the organisation work together to achieve the goals of the business. Each key business function must work effectively with other functions to ensure that the goals of the business are achieved. The business becomes a team in which the four key players must work together to win the game. Each function works independently and with the others to ensure the success of the business.

Source 5.5 The key business functions

How is the operations function related to marketing?

The **operations function** refers to the physical production of a good or the provision of a service. In the case of manufacturing, inputs are combined to process or transform them into a finished product. These inputs may be raw materials or partly processed products. For example, a burger shop will require an assortment of meat patties, vegetables, bread buns and sauces to present the customer with a finished product.

Operations function The physical production of a good or the provision of a service, such as a dental visit.

Operations works closely with the marketing department to incorporate product features that consumers will respond to positively. It is the responsibility of the marketing function to develop strategies that will sell the product.

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How is the human resource function related to marketing?

The **human resource function** deals with the relationship between the owners of a business and the people who work for the business. It is a support function that aims to find, attract, develop and motivate the people who can provide the services that the business requires. These human resources should have skills and abilities that are specific to the nature of their job. The business tries to acquire the right person for each job and to keep them on board, as well as improve the quality of their skills. Therefore, this business function involves acquiring, developing and maintaining staff and, if necessary, separating them from their current employer.

The **employment relations function** is focused on the role of employees within an organisation. Staff must be motivated and skilled to develop products within the business that cater to the needs and wants of potential customers. It is through the marketing process that a business is able to determine the skills required for employees to produce the desired product. The desired characteristics of the product would be identified by the market research conducted by staff. In many instances, staff are the public face of the business. Their actions towards consumers will influence the decision of a consumer to purchase a product, return to the business and recommend it to others.

How is the finance function related to marketing?

The **marketing function** involves discovering the needs and wants of consumers and aligning these findings to the business product. This research may result in changes to the features of a product or the development of a new promotional campaign. The financial resources that are available to the marketing function influence its ability to grow.

Human resource function Deals with the relationship between the owners of a business and the people who work for the business.

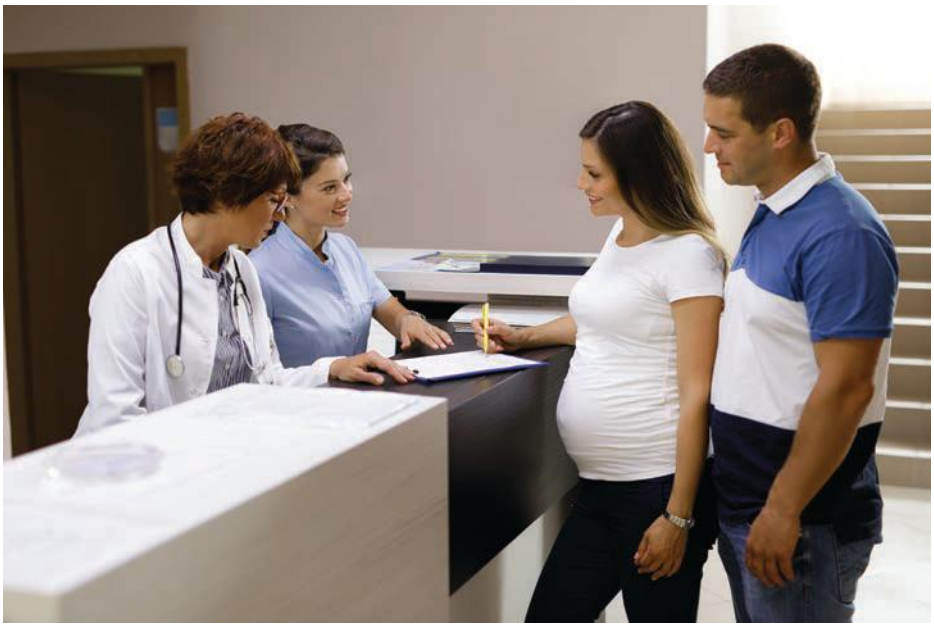
Employment relations function Deals with the role of employees within an organisation.

Marketing function Involves finding out what consumers want and need and attempting to link the results of this research to the business's product.

Finance function Provides the financial information needed for sound and viable decision-making.

The **finance function** is responsible for providing the financial information needed for sound and viable decision-making. A business must determine the total cost of producing a product in order to set an appropriate price or to assess the business's ability to acquire additional finance when and if it is needed. All these functions are interdependent. There is a heavy reliance on the functions to work in unison, leading to a more efficient and profitable organisation.

One of the key goals of marketing is to sell the goods and services that a business produces. This in turn benefits the profitability of the business. The organisation must also



Source 5.6 In many instances, staff are the public face of the business.

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consider whether the needs of its potential customers are financially viable for the business to pursue. Budgets and forecasts must also be established for promotional campaigns and sales.

Activity 5.1
Diagram

1 Construct a flow chart that identifies how marketing is reliant on the other key business functions.
2 For each section, specify how marketing assists the other three business functions achieve their objectives.

Digital quiz
Please see the Interactive Textbook to access digital activities.

5.3 Production, selling and marketing approaches

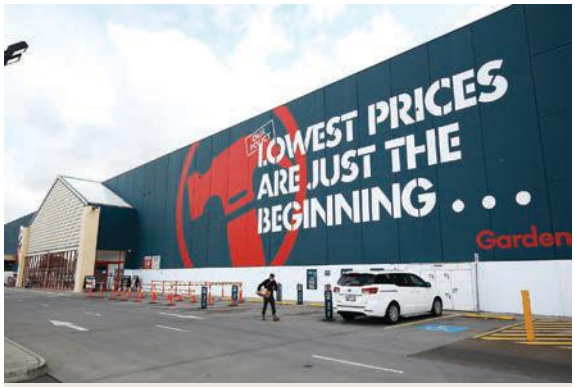
Businesses will often use a combination of strategies, all aimed at increasing product awareness and generating sales of their products by satisfying the needs of consumers. Marketing has not always been carried out in this way. Over the years, businesses have focused their efforts on single elements of the **marketing mix**, rather than a combination of strategies. This section will examine these different approaches to marketing.

Production approach

During the 1920s and 1930s, many businesses assumed that the high quality of a product would ensure its success within the marketplace. There was a view that consumers would seek goods based on the level of quality. The high price was merely a representation of the high quality. As a result, businesses placed considerable emphasis on ensuring that production methods were consistent with the high standards of quality expected. The business would focus on how the good was produced, as it believed that customers would be drawn to the quality of the product.

Marketing mix The process of developing a product that meets the needs of consumers and implementing a series of promotional, pricing and distribution strategies that will encourage consumers to purchase the product.

Selling approach Involves a business placing emphasis on strategies aimed at convincing consumers of the need to buy a product.



Source 5.7 Aggressive pricing strategies are an important component of the marketing campaigns for businesses.

Selling approach

While product quality was seen as an important feature of the marketing process, increased competition from globalisation meant that businesses began to believe that some consumers needed to be convinced of the need to buy a particular product. This saw the development of the **selling approach**, which involves a business placing emphasis on strategies aimed at convincing consumers of the need to buy a product. A good cannot be sold solely on the basis of its quality. People need to believe that the good will be of benefit to them.

While promotion played a role here, the aim was to take the product and its benefits to the consumer – through the all-important salespeople. These people were hired to communicate the virtues of their employer's products. Promotion assisted businesses in differentiating themselves from their competitors.

Ethical Spotlight 5.2

Examine the extent to which the selling approach contributes to the creation of consumer need. Do clever sales techniques convince individuals of the need to buy goods and services?

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Marketing approach

Both the production and selling approaches failed to consider the taste and preferences of their intended target markets. The marketing approach encapsulates the importance of developing an integrated approach to satisfying the needs of consumers. A product that is marketed successfully must incorporate a strategy to make the consumer desire the product and think it caters to their needs. It should be promoted appropriately and priced strategically to ensure consumers are willing to buy the good without concerns about its quality.

It makes little sense for a business to spend thousands of dollars researching and developing a product without providing avenues for the product to be appropriately promoted to increase awareness of it among a core group of customers. The pricing strategy used by the business must be able to generate a return on the funds invested by the owners of the business to develop the product. It must also be competitive and affordable for those to whom the product is targeted.

Review 5.2

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Distinguish between the production and selling approaches.
2 Outline the importance of market research in the marketing approach.

5.4 Types of markets

The production and sale of goods and services are not restricted or targeted solely at consumers. Businesses purchase their supplies from other businesses to produce goods and services that are then sold to consumers. These goods and services are known as inputs. Some organisations simply buy a finished good from a manufacturer to sell to consumers. Certain businesses will choose to concentrate on one section of the market, meaning they specialise their products to a select group of consumers. As can be seen, there is a diverse range of markets that demand goods and services.

Resource markets

Resource markets are those markets where the production and sale of raw materials occurs. Some businesses require materials (such as gold, aluminium, sugar or wheat) to produce the goods and services that they then sell to other businesses. These raw materials are traded in the resource market. Examples of businesses that operate in the resource market include Rio Tinto and Fortescue Metals, which produce iron ore, copper and coal, while GrainCorp specialises in farming and agriculture. Given that labour is a key factor of production, it can be argued that labour is traded in the resource market. While much of the Australian labour force is regulated through government legislation and tribunals, some employees are able to negotiate higher wages based on their ability, skill and reputation.

Industrial markets

Industrial markets are markets where goods that are used as supplies in the production process are traded. It is unusual for a business to develop all the resources it requires to produce finished goods. Campos Coffee is a successful coffee roaster that produces and distributes many specialty blends of coffee to cafes, hotels and restaurants. Campos Coffee sources beans from plantations in countries such as Kenya, Ethiopia and Papua New Guinea and converts these into coffee grinds ready for sale to other businesses. In 2020, Campos Coffee was named Champion Australian Roaster at the Australian International Coffee Awards. In recent years, the business has expanded its distribution network to include major supermarkets such as Woolworths.

Resource markets Markets in which the production and sale of raw materials occur.

Industrial markets Markets in which goods that are used as supplies in the production process are traded.

Source 5.8 Founder of Campos Coffee, Will Young, sources coffee beans from plantations around the world. Here he is in conversation with a supplier in Costa Rica.

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Intermediate markets

Intermediate markets are commonly referred to as wholesalers. They are often referred to as business-to-business markets, as they sell products to retail businesses that have been produced by other organisations. Wholesalers generally do not sell products to consumers. Chemist Warehouse purchases many of its products, including vitamins, fragrances and cosmetics, from the wholesalers in the intermediate market.

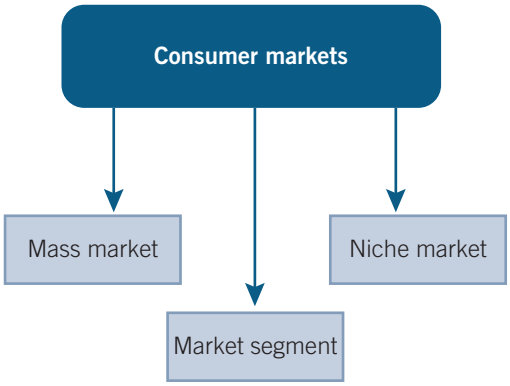
Consumer markets

Consumer markets are the most recognised markets in the business environment. They are often referred to as business-to-consumer markets, as businesses sell their products directly to consumers. Often the business will have purchased the products from other businesses that produce the item rather than deal directly with consumers. For example, Beats Electronics is a consumer audio manufacturer that produces wireless speakers and headphones such as the popular 'Beats by Dre'. The organisation does not sell its product direct to the consumer; it uses major retailers such as JB Hi-Fi and Bing Lee to connect with end users of the product.

Intermediate markets Markets in which retail businesses purchase products that have been produced by other organisations. Also known as wholesalers.

Mass market The market where the products are aimed at all consumers.

Consumer markets can be broken down into three categories (see Source 5.9).



Source 5.9 Types of consumer markets

Mass market

The **mass market** is the market where the products are aimed at all consumers irrespective of their age, gender, residential location or income. The business does not target its products at a particular buyer group. Products sold in the mass market have appeal to all consumers. Petrol, electricity, water and postal services are examples.

Market segments

A market segment is one area of a particular market. Businesses may choose to focus on a single market segment. TV stations often target one market segment of the combined TV audience. Kayo Sports, a recently launched TV subscription platform, specialises in providing sports content to males in the 18–45-year-old demographic. The organisation directs its marketing activities towards this segment, offering access to a mix of live sports, including NRL, AFL, NBA and NFL. Furthermore, Kayo Sports provides many additional programs, such as talk shows involving current and former players that the target audience easily identifies with.

Business Bite

Zjoosh is an Australian retailer that provides a large range of affordable fashion jewellery and accessories for women. The business sources stock from many locally produced items and supports upcoming and emerging designers. In recent years, Zjoosh has expanded its offerings to include clothing and sleepwear.

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Niche markets

A **niche market** is a smaller section of a larger market segment. While a business targeting a market segment would still focus on a select group of customers, a niche market differs in that its customer base is narrow. Owing to the small client base, sales are not as frequent, although the goods sold in this type of market are usually higher-priced than those in broader markets. Speciality stores such as bridal gown designers, sporting team stores and organic food stores are examples of such businesses.

Niche market A small area of trade within the economy, often involving specialised products.

Business Bite

Steven Khalil is one of Australia's highly regarded fashion designers. From humble beginnings in Sydney's west to dressing the likes of Jennifer Lopez and Kylie Jenner, Steven is one of Australia's sought-after designers. His dresses start at $10 000, with a minimum six-month wait.

Source 5.10 Bridal gown designers, such as Steven Khalil, are an example of a business type that targets a niche market of customers who are prepared to pay high prices for custom-made products.

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Review 5.3

Classification

Identify the types of markets in which the following business transactions occur:

1. A company extracts coal from a mine in northern Queensland.
2. A pre-made meal business uses plastic containers produced by Visy.
3. A bottled water manufacturer has released a range of different sizes that appeal to a variety of consumers.
4. Officeworks sells a range of laptop brands, including Apple, Microsoft and Dell.
5. A retailer specialises in selling surfboards to teenagers.
6. A radio station believes its niche market to be women aged 40 years and over and interested in rock music.

Chapter summary

Marketing is the process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers.

The strategic role of marketing refers to the long-term role that the key business function of marketing has within a business. The strategic role of marketing involves five key areas:

- Choice: businesses differentiate themselves from their competitors through price, product quality and features, and service. All these provide consumers with greater choice when purchasing a product.
- Standard of living: businesses will often develop and market products that improve and enhance standard of living.
- Employment: to provide a product to consumers, businesses must employ labour to assist in transforming input resources into finished products. Labour is also required in order to sell these goods and services.
- Brand awareness: the extent to which customers are aware of a product/brand and its features.
- Market share: businesses will attempt to develop, promote and price products to a standard that will give the organisation more customers than its competitors.

Marketing is one of four key business functions. The other business functions are operations, human resources and finance. Each of these functions works closely with the others to achieve the goals of the business.

There are three core approaches to marketing:

- production approach: relying on the view that consumers base their purchasing decisions on the quality of the product
- selling approach: based on the belief that a business will be successful in selling a product if it is able to promote the benefits of the product to its target market
- marketing approach: the basis of this being that the customer is at the core of all business activities; it involves adopting a customer orientation with the belief that all actions in the business should be aimed at satisfying the needs of the customer.

The four markets in the marketing process are resource markets, industrial markets, intermediate markets and consumer markets.

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Consumer markets consist of the following markets:

- mass markets: applying to goods and services that appeal to all types of consumers
- market segments: where a business chooses to focus on only one area of a particular market
- niche markets: a smaller section of a market segment.

End-of-chapter tasks

Chapter revision task

Rewrite the following passage, using the words listed in the box below to fill in the blanks.

employment	finished	community	consumers
health	marketing	percentage	aware
improving	competitors	price	labour
product	income	competitors	increase
minds	research	living	differentiate
convenient	input	particular	

There are five key strategic roles of _____ in the firm and society:

1 Choice: Marketing provides _____ with a choice. Businesses will often attempt to _____ themselves from their _____. They can do this through _____ quality, _____, service, packaging and loyalty programs.

2 Standard of living: Many of the products that businesses develop and market are aimed at _____ our quality of life and standard of _____. They do this by providing goods that improve our _____ and wellbeing, developing goods and services aimed at making our lifestyles more _____ and working with governments to distribute essential _____ services.

3 Employment: To provide consumers with a product to sell, a business must employ _____ to assist in transforming _____ resources into a _____ product. It also uses the skills of this labour to _____ and develop methods of improving this product. In this way, marketing provides a valuable source of _____ and _____ to millions of Australians.

4 Market share refers to the _____ of total sales a business has compared with its _____ in a particular market. The purpose of attempting to _____ the market share of a business is to increase the business's sales and profitability.

5 Brand awareness refers to the extent to which consumers are _____ of the existence of a _____ product, its features, price and possible stores of purchase. Strong brand awareness allows a product to remain in the _____ of consumers.

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Multiple-choice questions

1 How is marketing best defined?

A The process of developing promotional and pricing strategies to sell a product
B The process by which a business attempts to raise awareness of the goods and/or services it sells in the marketplace
C All forms of promotion, such as advertising, publicity and public relations
D The process of developing a product and implementing a series of strategies aimed at promoting, pricing and distributing the product to a core group of customers

2 Tesla Dom is an environmentally friendly chauffeur service that uses a fleet of zero-emission vehicles. The business has developed a new marketing plan that seeks to attract the interest of ethically minded consumers. Which strategic role of marketing is this concerned with?

A Choice
B Market share
C Standard of living
D Brand awareness

3 Why would a business choose to sell to a niche market?

A It is very expensive to market correctly.
B A business can charge higher prices due to its differentiation.
C There is no need to customise the product strategies.
D All customers have the same needs.

4 Which of the following is a product that is sold in the mass market?

A A product that has appeal to a limited number of individuals
B A product that is characterised by a high price and low sales
C A product that has appeal to a number of different groups
D A product with features and attributes that are very similar to those of competitors' products

5 Big Gainz has developed a range of protein bars targeting males 18 to 35 years of age who frequent the gym. What market is Big Gainz participating in?

A Resource market
B Intermediate market
C Market segment
D Select market

6 With information obtained from market research, Therese hopes to establish a product that is more suited to consumers' needs, using relevant pricing and promotional strategies. Which form of approach would Therese be using?

A Production
B Selling
C Marketing
D Societal

7 'Because you're worth it' and 'Taste the feeling' are slogans that L'Oréal Paris and Coca-Cola, respectively, use to promote the value of their products. Which approach does the use of slogans best represent?

A Selling
B Marketing
C Societal
D Production

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8 Which of the following statements best describes the relationship between the marketing and operations functions of a business?

A The operations department works closely with the marketing department to incorporate product features to which consumers will respond positively.
B The operations department produces goods and services within a budget developed by the marketing department.
C The operations department is responsible for the recruitment of staff, who then produce goods and services favourable to the needs and wants of consumers.
D The operations department develops goods and services that the marketing function becomes responsible for promoting.

9 Ohana Fisheries is a leading Australian commercial fishing company. Which type of market does the business operate within?

A Resource
B Industrial
C Intermediate
D Consumer

10 Sylvia Shimmer is a business that specialises in the production of female beauty products. Its main marketing activities are focused on sales representatives visiting homes, shopping centres and community gatherings to persuade potential customers to buy their products.

Which of the following marketing approaches relate to Sylvia Shimmer?

A Production
B Selling
C Marketing
D Relationship

Short-answer questions

1 **A** Discuss the benefits of targeting a niche market.
B Describe and give examples of the three types of consumer markets.

2 Andrew operates a frozen yoghurt store. He firmly believes the key to the business's success has been its consistent advertising on social media. Marissa decided to open a similar store and has embarked on conducting market research to gain a better understanding of the needs of her customers.

Discuss how the approach used by Marissa differs from that used by Andrew.

Extended-response question

'Marketing involves the use of strategies to communicate value to consumers.'

With reference to the above statement, explain why goods and services are central to the success of a business.

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6 Influences on marketing

Chapter objectives

In this chapter, students will:

- identify the factors that influence customer choice
- analyse the role of consumer laws
- evaluate the influence of ethics on marketing.

Key terms

- implied condition
- price discrimination
- price–quality interaction
- psychological factors
- sugging
- unconscionable conduct
- warranty

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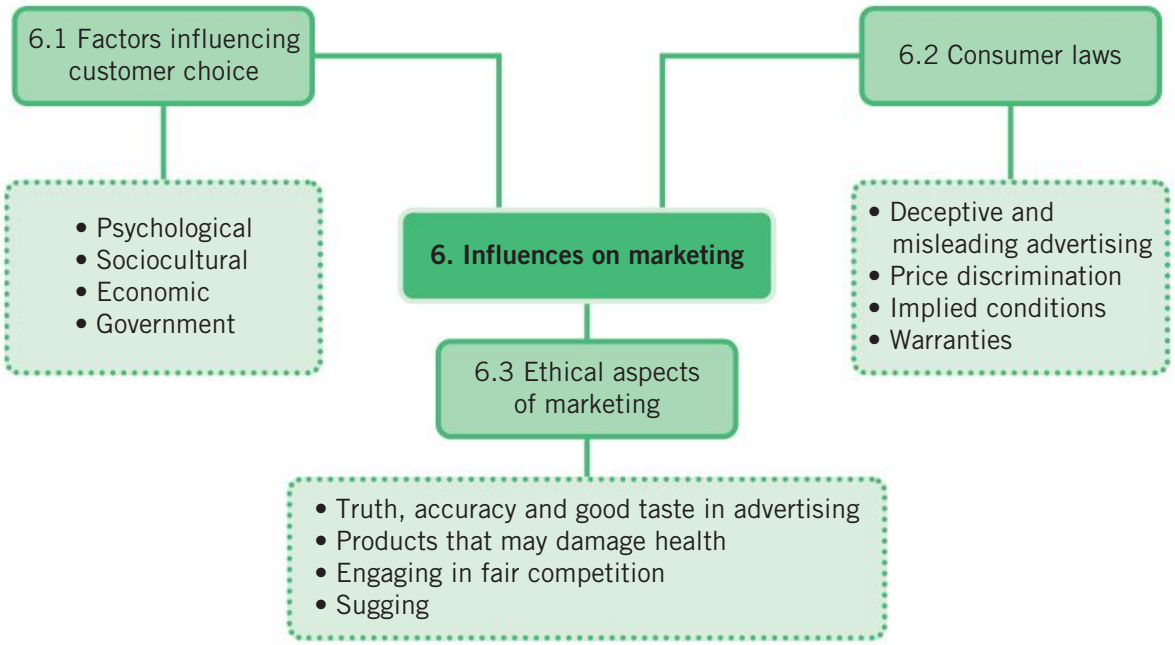
6.0 Introduction

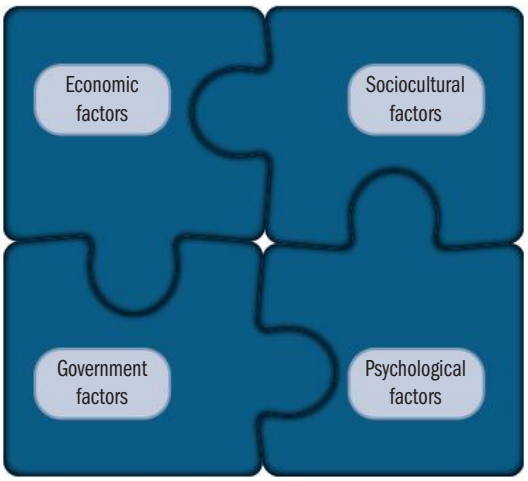


Source 6.1 Influences on marketing concept map

The marketing function in a business environment is influenced by the factors impacting upon customer choice, the laws that protect customers and the regulations that govern business practice. Businesses are also expected to comply with society's standards for behaviour and, therefore, act ethically.

6.1 Factors influencing customer choice

Factors outside the business environment will often play an important role in the success of an organisation's marketing plan. While the business has no direct control over these factors and customer buying behaviour, it is essential that the business has a strong understanding of how such factors can influence the buying behaviour of its customers. The four key factors influencing consumer choice are psychological, sociocultural, economic and government.



Source 6.2 Factors influencing consumer choice

Digital quiz
Please see the Interactive Textbook to access digital activities.

Psychological factors

Psychological factors are the personal characteristics of an individual that influence their behaviour.

Psychological factors The personal characteristics of individuals that influence their behaviour. These factors relate to the way people think and their attitudes.

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These factors relate to the way people think and their attitudes to certain products and brands. The psychological factors that influence the different types of goods and services customers buy include:

- motivation
- perception
- learning
- beliefs and attitudes
- lifestyle
- personality and self-concept.

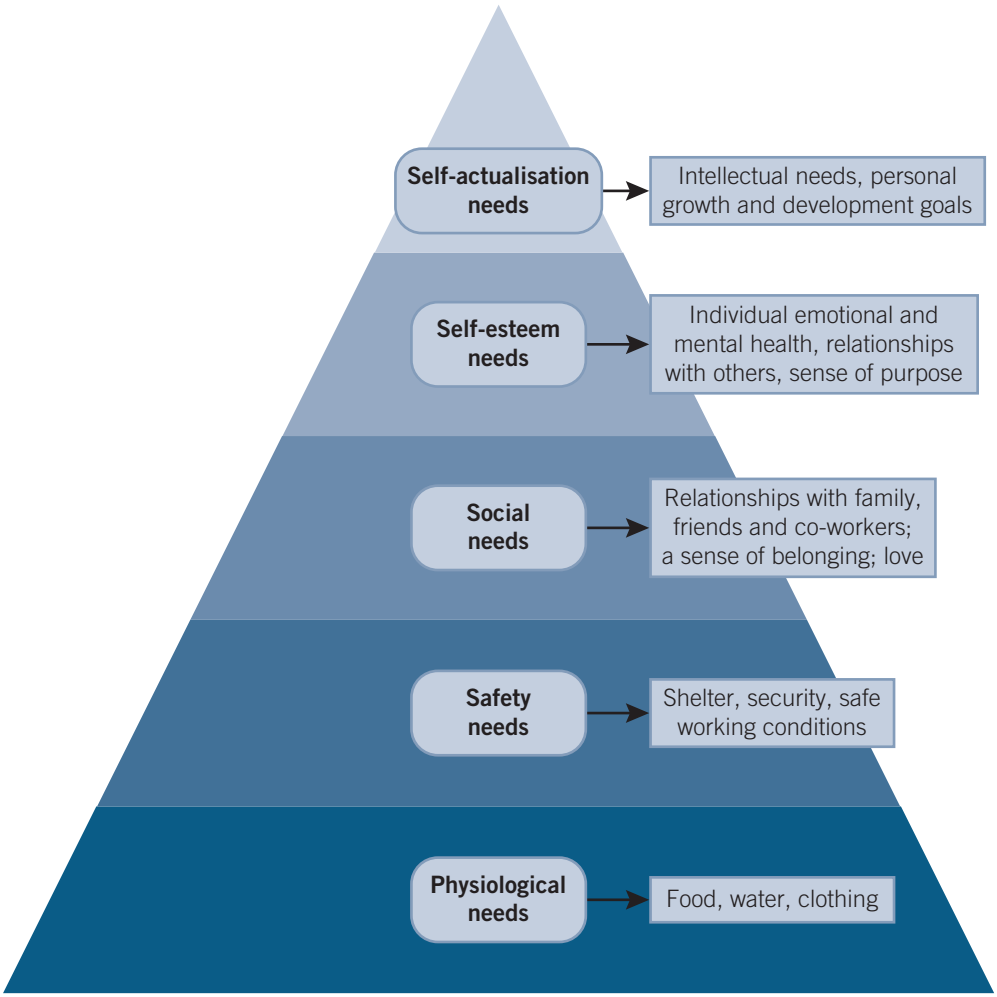
Motivation

When consumers have decided to buy a product, there is a belief within them that they need the product. Various factors will have influenced this decision for the product to be thought of as a need. To understand the motivational forces that cause consumers to act on their perceived needs, we can look to Abraham Maslow's hierarchy of needs (see Source 6.3).

Maslow, who was one of the world's leading psychologists, studied the forces that motivate humans. He attempted to explain why people have different needs at different stages of their lives. Maslow believed that there is a hierarchy of needs, the foundation of which are the basic needs (such as food and shelter). People will ensure their basic needs are met first before they seek to meet other needs, such as education and love. If consumers are not able to satisfy their basic needs, they will not be motivated to satisfy other desires within the hierarchy of needs.

Perception

Perception is the opinion that a customer has about a particular product. As consumers vary, different people may perceive the same product in different ways. It could depend on the amount of information gathered, the age of the consumer or cultural differences, such as the consumer's ethnicity or religion. It is important that businesses



Source 6.3 Maslow's hierarchy of needs

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develop a marketing mix that promotes to the targeted customer group a positive image of the product – an image that the consumer relates to and identifies with. This may include a focus on the product's quality or promotion of the product's health benefits. Price is becoming an increasingly important influence on consumers' perceptions of a product. Some consumers perceive the quality, reliability and reputation of a product to be reflected in its price. This is known as the **price–quality interaction**. Leading European car manufacturers (such as Ferrari and Porsche) are priced at the higher end of the luxury motor vehicles market. As such, consumers associate these products with images of prestige, quality and reliability.

Price–quality interaction The degree to which price influences the perceived quality of a good or service held by consumers. A high price is generally associated with luxury and prestige.

Business Bite

It all started in 2002 when a young entrepreneur from Adelaide, Nick Palumbo, established a new gelato bar in Darlinghurst, Sydney. Since then, the business has become one of the most recognisable brands in the frozen dessert industry. Key to Gelato Messina's success is that all ingredients are produced from scratch, with new special flavours released online weekly. The business now has 22 stores nationwide and, in 2019, collaborated with Peters Ice Cream to create the Drumstick X Messina range available in all major supermarkets. Recently, Messina also developed limited editions such as Mother's Day Bon Bons, or Mardi Gras Specials.

Source 6.4 Messina's creative department develops new and exciting flavours each week.

Learning

Learning describes the changes in an individual's behaviour as a result of an experience. This experience could be the consumer's use of a product, increased awareness of its features or learning about a friend's perception of the product. Consumers learn from each purchase they make. They determine the level of satisfaction they gain from using the product. Consumers also decide whether they will purchase that product again or make a further purchase from the business where the product was bought. Consumers also learn from reviews about different products, brands and experiences.

Business Bite

The presence of social media has meant that consumers are more connected than ever. While this brings many opportunities for businesses, significant challenges exist. The growth of social media platforms, digital shopping apps and comparison websites has contributed to

Continued →

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Source 6.5 Research shows that peer ratings heavily influence our purchase decisions.

the influence of 'peer endorsement' in marketing. Apps such as Uber Eats and Deliveroo allow consumers to rate the quality of the food and service from respective restaurants. While these ratings are not regulated, recent studies confirm that the purchase decisions of teenagers and young adults are strongly influenced by the average ratings from their peers.

Beliefs and attitudes

Our beliefs and attitudes are shaped by our environment and life experiences. They include our ethnic or religious beliefs and our political persuasions or attitudes towards social issues, such as the environment, animal cruelty or child labour. A consumer's attitude towards a particular product is clearly influenced by their broader beliefs and attitudes. Businesses cannot always influence a consumer's beliefs and attitudes. Factors such as culture or religion may prevent certain consumers from buying particular products.

Source 6.6 Religious beliefs influence the products that customers consume.

Lifestyle

Lifestyle is a significant influence on buyer behaviour. People of similar age and income will not always buy the same goods and services. Leisure preferences, interests, attitudes and gender all influence a person's lifestyle. From a marketing perspective, it is important that a business considers the influence of lifestyle on the demand for its product. The business should look beyond specific target groups (such as consumers of a certain age and income level) and instead determine what sort of lifestyle its target consumers will most likely have.

Personality and self-concept

The way we view ourselves and the way we respond to other people's perception of us will influence the types of goods and services we purchase. The basis for this idea is that we buy products that often reflect our personalities. For example, people who participate in sports such as basketball may shop at stores that stock items such as Nike, Adidas and Spalding. Aligning a celebrity with a brand can attract customers who associate with that person. Michael Jordan, one of the world's greatest basketball players. Endorses Nike products such as his Air Jordan range. So great is Michael Jordan's global appeal that Nike has expanded the Air Jordan range, having collaborated with Paris Saint-Germain Football Club.

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Sociocultural factors

Sociocultural influences on a customer's choices are those that come from the customer's society and culture. Culture can be defined as an individual's values, beliefs and customs. It influences almost every aspect of human behaviour, including our attitudes towards the various products offered within the marketplace.

Businesses have recognised the increasing importance of catering to the cultural beliefs and attitudes of particular groups within the community. This presents a business favourably in the community and allows it to expand its available market, both of which will benefit the business.

Business Bite

The values of society in Australia have changed considerably over the past 20 years. Consumers are becoming more ethically minded and demand that businesses respond accordingly. Cadbury, a leading chocolate and confectionary brand, has amended its product strategy to meet the attitudes of its target market. The business's most popular product, Cadbury Dairy Milk chocolate, is made using 100 per cent sustainably sourced cocoa. Part of the proceeds from the sale of every Dairy Milk chocolate bar is donated to local communities to educate cocoa farmers and combat deforestation.

Source 6.7 Social responsibility is a value that consumers seek in a brand when purchasing.

Economic factors

A person's socioeconomic status is largely determined by their level of income, occupation and level of educational attainment. Socioeconomic status is a significant influence on the types of goods and services a consumer will buy. In marketing terms, people from a high socioeconomic background are classified based on their income and asset levels. They are people who have a high income, are often university educated, are either professionals or self-employed and are willing to spend their income on goods that are perceived to be prestigious. In the majority of instances, the more income an individual earns, the greater is the individual's ability to purchase goods and services from a higher price range. This allows them to seek products with superior quality, advanced features and a more prestigious reputation. However, all adults must devote part of their income to essential forms of expenditure. Essential expenses could include costs related to rearing children, paying a mortgage loan or rent, and saving for future needs such as retirement. Consequently, high-income earners will not always be able to purchase products aimed at their particular income group.

However, in comparison with a low-income earner, a person with a high income is more likely to be able to borrow from financial institutions. Banks, credit unions and finance companies hold the view that the ability of a person to repay debt is significantly influenced by their income.

Government factors

While it may not appear to directly do so, the government is an important influence on the goods and services that consumers purchase. One of the key government factors influencing customer choice is the federal government's regulation of the economy. This regulation takes place through the implementation of the government's fiscal and monetary policies and through microeconomic

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reform. Fiscal policy refers to the actions taken by the federal government to influence economic activity through the use of its budget. This can impact on the level of taxation consumers pay in the form of income tax and the goods and services tax (GST).

Monetary policy is used by the Reserve Bank of Australia to influence the level of economic activity through the use of interest rates. Interest rates are significant in determining the level of spending in the economy and the level of credit that consumers and businesses will access. Microeconomic reform is where the government makes policies to promote greater competition within a particular industry. It has proved to be successful in the telecommunications, finance and airline industries. It has offered consumers greater product choice and lower prices.

Governments also play an important social role in influencing customers' purchasing behaviour.

Source 6.8 GST (goods and services tax)

Age restrictions on the purchase of alcohol and tobacco and censorship warnings on television programs and films reflect the government's role in promoting social responsibility in the community. In 2018, the federal government introduced GST on products purchased via eBay from other nations. The purpose was to encourage Australian consumers to purchase from online stores based in Australia.

Business Bite

The government aims to restrict the consumption of certain goods and services by imposing regulation. Recently, the NSW Government restricted the advertising of gambling during the broadcast of any live sporting event on TV or radio. As gambling is prohibited for those under 18 years of age, the government was concerned that many teenagers were being exposed to the promotional campaigns of the gaming institutions, which encouraged impulse betting.

Source 6.9 The government restricts the advertising of gambling during live sports broadcasts.

Review 6.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Describe how a slowdown in economic activity will influence buying behaviour.
2 Explain the influence of peer groups on customer choice.

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6.2 Consumer laws

It is widely recognised that a successful business is one that looks beyond profit maximisation and is able to develop a motivated, skilled workforce while adopting ethical and legally correct practices through all operations of the organisation. Marketing has an important role in any business. It is the function that takes a product to the consumer. Given the significance of the marketing function, some businesses may attempt to develop practices that take advantage of consumers' trust and good faith in the organisation and its products. Businesses now operate within a legislative framework outlining the responsibilities of businesses in relation to the field of marketing. Businesses must be honest in all their interactions with customers.

The role of consumer laws

Consumer protection in Australia is the domain of state governments. Under the Constitution, state governments have responsibility for developing laws that protect the interests of consumers within the business environment.

The Commonwealth Government controls business behaviour through the *Competition and Consumer Act 2010* (Cth). This legislation attempts to promote fair and competitive behaviour in the marketplace.

While all levels of government acknowledge that businesses seek to be profitable for their owners and shareholders, the government also accepts that businesses should conduct themselves in a way that does not take advantage of consumers through misleading and deceptive behaviour.

Deceptive and misleading advertising

Advertising is one of the most powerful and effective methods of promotion. It takes the business and its products directly to the consumer. Because of its benefits, some businesses will attempt to use advertising in a way that is unfair, deceptive and misleading to the consumer.

Examples of deceptive and misleading advertising under the Competition and Consumer Act include:

- giving misleading information about a product's features, content or country of origin
- overstating the benefits that a product will provide to the consumer
- offering discounts and special offers that do not, in fact, exist
- using bait-and-switch advertising, which promotes a product that is heavily discounted even though the business has very limited supplies or no stock at all; when the consumer comes into the store and expresses an interest in buying the product, the salesperson will attempt to switch the consumer's interest to a more profitable item.

While the Competition and Consumer Act seeks to discourage businesses from **unconscionable conduct**, such as deceptive and misleading behaviour, consumers are responsible for reporting such cases.

Unconscionable conduct
Conduct that is morally unacceptable.

Source 6.10 Parliament House, Canberra. The Commonwealth Government controls business behaviour through the *Competition and Consumer Act 2010* (Cth).

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Defining misleading advertising and selling practices

Any kind of conduct or behaviour that could give consumers the wrong impression may potentially breach the Act. It doesn't matter whether the representation is deliberate or accidental. What does matter is the impression that is left in the mind of the customer. Various sections of the Act target specific types of trader behaviour:

- Businesses must have reasonable grounds when predicting future events. Businesses should consider, or adequately address, the range of uncertainties and variables involved. Example: a salesperson of electric vehicles misleads potential purchasers by falsely stating that the government will pass legislation to provide free charging for the lifetime of the vehicle. The salesperson continues to make these claims knowing there are no specific plans by the government.
- Commercial conduct must not mislead or deceive, or be likely to mislead or deceive. This is a very broad provision. Example: a fruit juice producer representing a product as being 100 per cent cranberry juice, when the product is 50 per cent orange juice. Example: a company representing that an international calling card has no fees, other than timed call charges, when in fact other fees are charged.
- Businesses must not make false or misleading representations about the characteristics of goods or services, including sponsorship, price, place of origin, guarantees, availability of spare parts and the buyer's need for goods. Example: a car company misrepresenting that a car has five doors when it actually has three. Example: a seller claiming that a product with significant imported components is 'Australian made'.
- Businesses must not engage in false or misleading conduct, or in certain other practices, when buying or acquiring an interest in land. Example: an agent misrepresenting fixtures to be included with rural land, the position of a 'beachfront' lot or suitability for strata conversion.
- Businesses must not engage in conduct that misleads or is likely to mislead people about the details of possible employment. Example: an educational institution offering 'scholarships via paid training courses' when, in fact, applicants are required to pay a substantial fee, there is no employment provided and the scholarships don't exist.
- If a seller makes a representation about part of the cost of goods or services, it must also specify the cash price of those goods or services. Example: a used car dealer advertising the price of a car as periodic repayments without stating the actual cash price of the vehicle.

Continued →

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- Businesses must not engage in conduct that misleads or is likely to mislead the public about the characteristics, suitability or quantity of services. Example: an allergy treatment company stating that it can cure or eliminate virtually all allergies or allergic reactions when the company actually cannot do this.
- The Australian Consumer Law (ACL) prohibits false or misleading conduct in connection with work-at-home schemes, or other business schemes requiring investment and/or labour by participants. Example: a person being misled about the profitability of a worm farm investment scheme. Example: a company misrepresenting the level of business available to drivers.

Source: Australian Competition and Consumer Commission, *Advertising and Selling Guide*.

Review 6.2

Comprehension

Answer this question on paper or in the Interactive Textbook.

1 Explain how deceptive and misleading promotion may impact a business's sales.

Activity 6.1

1 Research a case where a business was found to be engaged in deceptive conduct. Were the actions of the business purposefully deceptive?

Price discrimination

Price discrimination refers to a business giving preference to some retail stores by providing them with stock at lower prices than is offered to the competitors of those retailers. The competitors are discriminated against by being forced to pay a higher price for a product that is identical to one the other retailers are receiving at a discounted rate.

The Competition and Consumer Act aims to discourage price discrimination in the business environment. It is uncompetitive and can often disadvantage smaller businesses that have less influence in the marketplace. The Act does, however, allow businesses to provide different prices to different stores for identical goods should one business order a bulk quantity. This is a method by which businesses can engage in price discrimination and are legally able to do so.

Implied conditions and warranties

Consumers are always protected from buying faulty goods or goods not fit for their advertised purpose by consumer law. When purchasing a product, the consumer expects that the business will fulfil its legal obligation to provide a good or service that is consistent with the description given and is in full working order. There is an **implied condition** that the good sold will be of merchantable quality and be reasonably fit for the purpose for which it is commonly bought. A business must, by law, either refund a customer's money or offer an exchange of the good should the good be recognised to have been faulty at the time of leaving the store. This is why all products are said to have a **warranty**. By administering this legislation, state governments seek to ensure consumers' rights are protected.

A good way for a business to show its faith in the products it sells is to offer a warranty beyond that required by law. Australian consumers receive five years' warranty for the purchase of a new car from most of the well-known car manufacturers. Kia, however, extends this warranty for an additional two years, differentiating itself from its competitors. Warranties can be a very powerful marketing tool for a business to attract customers.

Price discrimination A business giving preference to some retailers by providing them with stock at lower prices than are offered to the retailers' competitors.

Implied condition An expectation by consumers that a good purchased will be fit for its intended purpose, of an acceptable quality and match the description advertised.

Warranty Regardless of whether a product is carrying a warranty, a business must, by law, either refund a client's money or offer an exchange of the good should the good be recognised to have been faulty at the time of leaving the store.

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Source 6.11 Kia offers an extended seven-year warranty on all its vehicles.

Resale price maintenance

Businesses will often seek to balance the competing goals of profit maximisation with a competitive pricing strategy. Under the *Competition and Consumer Act 2010*, a manufacturer cannot refuse to sell goods to a retailer who decides not to sell the goods at the price that is suggested by the manufacturer. Businesses may be offered suggested prices at which to sell a good. This is seen in stores as the recommended retail price. Some businesses choose to go below this recommended price. A manufacturer cannot discriminate against stores for selling at a price that is lower than it has recommended.

Review 6.3

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Discuss the remedies that a consumer is entitled to if a product is faulty.
2. Outline the penalties that may be imposed for a business engaging in deceptive and misleading advertising.

6.3 Ethical aspects of marketing

Ethical behaviour is a fundamental aspect of a successful business. Ethics represent actions taken by businesses to act as responsible corporate citizens within the community. Ethics are the cornerstone on which all responsible businesses are established. Ethics in marketing refers to a combination of broad principles that establish standards of behaviour and guidelines for people working across the marketing industry. They are not enforceable through law and rely on the goodwill of all stakeholders in the business process to work successfully.

Truth, accuracy and good taste in advertising

A marketing campaign is established to promote consumer awareness and interest in a particular product. It is also designed to increase a product's sales and increase the market share of a business. Given this, businesses spend considerable amounts of money each year on promotional campaigns. Marketers are expected to engage in fair and honest behaviour when developing a marketing campaign. It is expected that when promotional material is distributed, this material represents information that is truthful, accurate and in good taste. Failure to do this may result in a breach of the *Competition and Consumer Act 2010* (Cth). The Act prohibits a business from supplying goods that do not comply with prescribed product safety standards.

The Advertising Foundation of Australia (AFA) works alongside the legislative framework. This is the peak body representing companies in advertising and marketing communications.

Business Bite

Youfoodz is an Australian food delivery business that provides ready-to-eat meals to consumers nationwide.

In 2017, the business received negative publicity for airing a TV commercial during prime time that featured a young child impersonating celebrity chef Gordon Ramsay. In this ad, the young boy repeatedly mimicked Ramsay, using the term 'forking' as a play on words. The Advertising Standards Bureau (ASB) received many complaints from parents and members of the community concerned by the inappropriateness of the ad. Many consumers felt that the Youfoodz ad was not in good taste.

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The AFA seeks to promote best practice in advertising by members of the industry. This also includes compliance with the codes and laws that affect advertising. The AFA is also referred to as the Communications Council.

Brand awareness is a key component of a business's marketing strategy. It allows the business and its products to become known and readily recognised. Some organisations, however, will seek to implement strategies that create some degree of controversy. Not only does this promote the business and/or its product, but it also encourages the media to facilitate debate regarding the nature of the advertisement. This debate serves only to generate further publicity for the business – publicity that would normally costs thousands and thousands of dollars.

The concept of taste in advertising is subject to considerable debate. One individual's reaction to an advertisement may differ from that of another individual. Lush, a leading cosmetic brand, has positioned itself as an organisation that supports social causes. Its 2018 '#spycops' campaign against undercover police officers' behaviour in the United Kingdom caused widespread controversy among a large portion of its target market.

Ethics in advertising is outlined by the Communications Council (the AFA). Its Code of Ethics outlines key principles to be followed in the process of developing advertisements.

Source 6.12 The cosmetic store Lush featured prominent window displays with fake police tape and posters.

Ethical Spotlight 6.1

Should businesses be prohibited from using gender stereotypes in advertising? Should ad campaigns that objectify women be banned?

Business Bite

Source 6.13 The gamification market is expected to reach a global value of US$22.9 billion by 2022.

The use of gaming apps that are associated with major fast-food brands raises significant ethical issues. McDonald's Monopoly app and KFC's Snack! in the Face app encourage consumers to download and play arcade-style games for their chance to win prizes. These prizes include cash, cars and free food purchases. Many experts believe that this process of gamification is unethical, as it promotes the consumption of junk food that may damage their health to young children.

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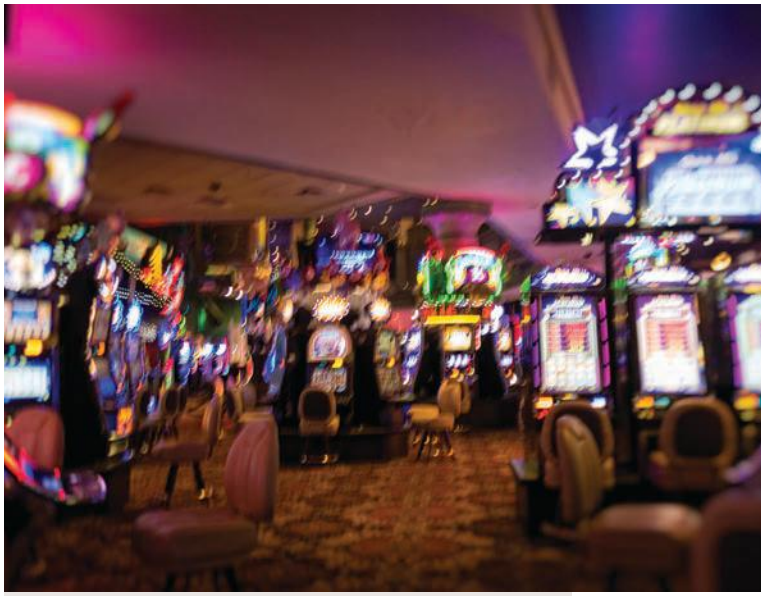
Products that may damage health

The nature of Australian businesses is guided by government policies that seek to encourage competition in the marketplace. Competition benefits businesses through increased product innovation, improved manufacturing techniques and greater workplace efficiency. Another key benefit is that it provides consumers with more choice.

The federal and state governments have sought to restrict the provision of various goods and services that may act as a health detriment to the consumer, without applying a ban on their sale.

These goods and services are often referred to as 'sin' goods because, in essence, they are bad for us. These goods are also known as demerit goods. Examples include the sale of cigarettes and alcohol, tobacco sponsorship and entry into casinos.



Source 6.14 Entry into a casino in Australia is thought of as a demerit good.

Source 6.15 Measures used to control the selling of restricted goods

Tobacco – sold widely across Australia	Purchases restricted to people aged 18 and over
	Plain-style packaging Must not be displayed openly
	Packets contain health warnings
	Unable to sponsor sporting/community events
Alcohol – sold across Australia	Purchases restricted to people aged 18 and over
	All staff serving alcohol must complete Responsible Service of Alcohol training
	Sponsorship of sporting/community events permitted
Casino/gaming – restricted to people aged 18 and over	Visible and clear information informing people of support services for gambling addiction
	Restricted opening hours for leagues and RSL clubs

Engaging in fair competition

Businesses across Australia operate in highly competitive environments, with considerable amounts of money spent each year in order to increase sales and market share. Given this, some businesses do attempt to engage in behaviour that is either legally or ethically unfair to their competitors.

From a legal perspective, it is the role of the Australian Competition and Consumer Commission (ACCC) to regulate business behaviour. Common practices of unfair competitive behaviour include:

- price-fixing between two or more major competitors in the market with the aim of reducing competition
- long-term loss leader – pricing strategy undercutting smaller competitors in the short term, forcing the smaller businesses to engage in a price war
- misleading advertising regarding the products of a competitor.

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Australian Competition and Consumer Commission

The ACCC was formed in 1995 and has as its primary role the administration and enforcement of the *Competition and Consumer Act 2010* (Cth) and the *Prices Surveillance Act 1983* (Cth).

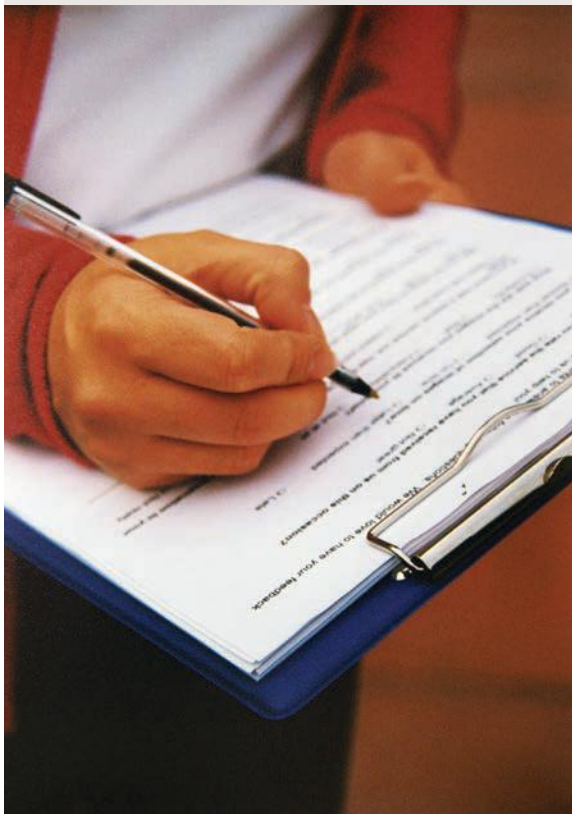
The ACCC attempts to regulate the level of competition within a range of industries. It aims to promote fair and ethical behaviour by businesses towards their competitors and allows businesses to lodge complaints against competitors regarding behaviour that they deem to be unfair and against the Acts. The ACCC is also able to penalise businesses that engage in deceptive and misleading conduct or price-fixing. Price-fixing occurs when two or more business competitors combine to set a high price within the market. This reduces the level of competition within the market.

Sugging

The competitive business environment leads some businesses to engage in unethical marketing practices, such as **sugging**. This process involves selling under the guise of research. Consumers are asked general questions on a range of topics, such as 'Where would you like to go for a holiday?' and 'How often do you use food delivery services?' From the responses, the interviewer is able to determine the needs of the consumer and suggest products offered by the business that cater to these needs. The ethical issue here is whether the consumer is aware that the business is, in fact, attempting to promote and sell its products from the outset of the interview – that is, when the questions were first being asked. Sugging is regarded as unethical because the consumer is not aware that they are being encouraged to buy the product.

Sugging A disguised marketing process that uses general questions in a survey or questionnaire to determine the interests and needs of a consumer and then offers the consumer a product that the business believes caters to the consumer's needs.

Source 6.16 Sugging involves selling under the guise of research.



Digital quiz
Please see the Interactive Textbook to access digital activities.

Business Bite

The ACCC aims to protect consumers by monitoring the behaviour of all businesses. The ACCC has the power to impose penalties such as fines and require that corrective notices be publicly displayed.

Coles was fined $2.5 million in 2015 for making false representations and engaging in misleading conduct in relation to its fresh bread products. The business claimed on its packaging that the bread was 'Freshly Baked In-Store', when in fact it was partially baked and frozen off-site and then 'finished' in-store within Coles supermarkets.

Video 6.1 Consumer laws and ethical behaviour

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Chapter summary

There are four key factors that influence consumer choice: psychological, sociocultural, economic and government.

Psychological factors are the personal characteristics of individuals that influence their behaviour. These factors relate to the way people think and develop attitudes to certain products. Psychological factors include a consumer's understanding of a product and what motivates the consumer to purchase particular products.

Economic factors relate to an individual's level of income and ability to access credit.

Sociocultural influences on a customer's choices are those that come from the customer's society and culture, such as where they live and their religious beliefs.

The government has an important role in influencing the goods and services that consumers purchase. It does this through its use of fiscal and monetary policies, microeconomic reform and age restrictions placed on the purchase of specific products.

Under the *Competition and Consumer Act 2010* (Cth), businesses are prohibited from engaging in deceptive or misleading conduct. This extends to conduct in the area of marketing, such as advertising, sales promotions and discounts.

Price discrimination refers to the process of a business giving preference to some retail stores by providing them with stock at lower prices than are paid by the retailers' competitors.

Implied conditions and warranties ensure that a product is sold in full working condition and is consistent with the description given.

Resale price maintenance ensures that a manufacturer cannot refuse to sell goods to a retailer who decides not to sell the good at the price that is suggested by the manufacturer.

Marketers are expected to engage in fair and honest behaviour when developing a marketing campaign. It is expected that when promotional material is distributed, this material represents information that is truthful, accurate and in good taste. Failure to do this may result in a breach of the Competition and Consumer Act.

The federal and state governments have sought to restrict the provision of various goods and services that may act as a health detriment to the consumer, without applying a ban on their sale.

Some businesses do attempt to engage in behaviour that is either legally or ethically unfair to their competitors.

From a legal perspective, it is the role of the Australian Competition and Consumer Commission to regulate business behaviour.

Sugging is the process that involves selling under the guise of research.

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End-of-chapter tasks

Chapter revision task

Match the sentences below with the appropriate business term.

Sentences

1 These factors relate to our thoughts and attitudes towards particular products.

2 This is the image a particular product or brand has in the mind of a consumer.

3 Our perceptions of and attitudes towards particular products are influenced by this.

4 An individual with a high income may purchase goods and services of this kind.

5 An organisation that influences the types of goods and services consumers purchase.

6 Factors related to an individual's level of income and financial commitments.

7 An important factor influencing the perception of a product.

Business terms

high value, positioning, economic, reputation, culture, psychological, government

Multiple-choice questions

1 The process of sugging is:

A illegal and unethical.
B legal but unethical.
C legal and ethical.
D illegal but ethical.

2 Nick and Theo visit an electronics store after seeing a fitness watch advertised online for $50. When they reach the store, the salesperson advises them that the product is sold out. The brothers are then shown a more expensive alternative that is available to purchase.

This process is known as:

A bait-and-switch advertising.
B sugging.
C false advertising.
D implied conditions.

3 Which of the following best describes a social influence in marketing?

A Businesses employing more women in leadership roles
B Consumers increasing their level of spending on luxury goods during a boom
C Businesses adopting recycling practices in their operations
D Fast-food companies displaying the nutritional information of their products

4 George is a bodybuilder and is very conscious of the food he eats. To assist with his fitness regime, George consumes high-protein foods such as kangaroo and tofu.

What psychological factors reflect George's consumer behaviour?

A Lifestyle
B Culture
C Income level
D Social responsibility

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5 People of similar age, income and ethnicity will not always buy the same types of goods. What factor influencing consumer choice is reflective of this?

A Culture
B Lifestyle
C Socioeconomic status
D Government

6 What are two economic factors influencing consumer behaviour?

A Culture and lifestyle
B Income and financial commitments
C Culture and socioeconomic status
D Perception and culture

7 Which of the following best demonstrates the psychological influence in marketing?

A Strong growth in the Australian economy
B A significant reduction in the number of beer drinkers
C Australian customer perceptions that phones developed in China are better quality than those produced domestically
D An increase in the GST from 10 per cent to 15 per cent

8 Dennis decides to buy an expensive pair of shoes after seeing his friend Leon wear them. What factor influenced Dennis's decision?

A Attitudes
B Motives
C Sociocultural
D Self-image

9 The Australian Government announced that it will be providing families with a range of tax cuts as a means of encouraging further spending. Which government policy is this an example of?

A JobKeeper
B Microeconomic reform
C Fiscal policy
D Monetary policy

10 Which of the following represents a criticism of the concept of sugging?

A It promotes products in a misleading manner.
B Consumers are made to believe that the purpose of the questionnaire is legitimate market research.
C Consumers pay higher prices.
D The business is able to identify the needs of consumers in a deceptive way.

Short-answer questions

1 Describe how an individual's income level may impact on the type of brands they purchase.

2 Explain how psychological factors influence customer choice.

Extended-response question

Examine the legal and ethical considerations for a business developing a new marketing campaign.

Digital resources

Visit the Interactive Textbook to access:

- interactive chapter Scorcher Quiz
- videos, image galleries and other extra materials.

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7 Marketing process

Chapter objectives

In this chapter, students will:

- investigate the process of the situational analysis and market research
- analyse the importance of establishing market objectives and identifying target markets
- explain how marketing strategies are developed
- evaluate the implementation, monitoring and control of marketing processes.

Key terms

- controlling
- implementing
- market share analysis
- marketing profitability analysis
- monitoring
- primary data
- product analysis
- product life cycle
- sales analysis
- secondary data

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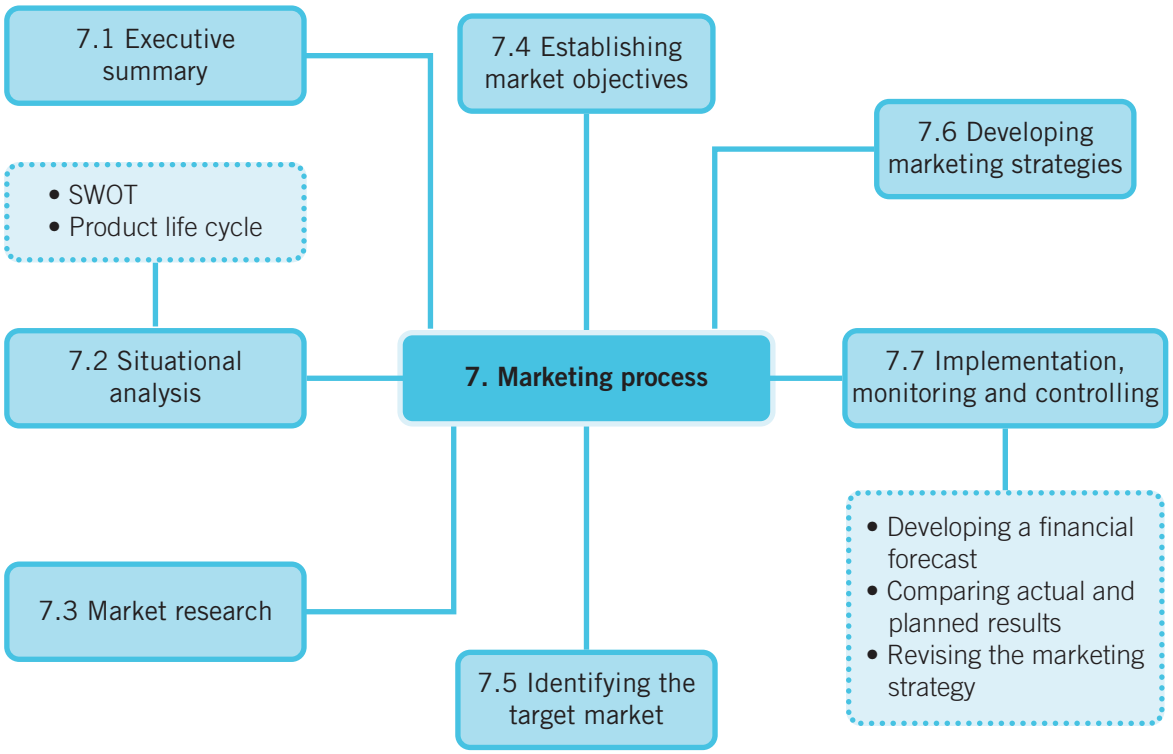
7.0 Introduction



Source 7.1 Marketing process concept map

Digital quiz
Please see the Interactive Textbook to access digital activities.

Planning is a central activity of any organisation. It allows a business to examine its current position within the market, consider opportunities to strengthen that position and determine the most effective method of implementing the required changes. This chapter examines the common elements involved in developing a marketing plan. These elements exist in all marketing plans regardless of the business's size, activity or legal structure. They are summarised in Source 7.2. How businesses develop the elements will vary. Some businesses have specialised marketing departments to devote considerable financial and human resources to their plan. Smaller businesses may engage the services of marketing firms, which would be an example of outsourcing.

Source 7.2 The elements of a marketing plan

Digital quiz
Please see the Interactive Textbook to access digital activities.

7.1 Executive summary

The executive summary provides a brief description of current issues facing the business. It provides a snapshot of the objectives and strategies that are to be featured in the marketing plan. A short summary of the main recommendations to be presented in the plan is also provided.

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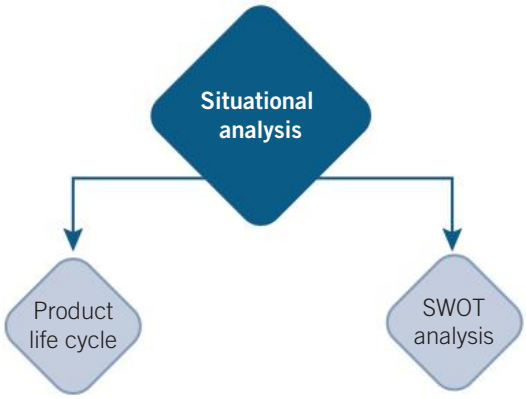
7.2 Situational analysis

The situational analysis provides the firm with an opportunity to examine its current position within the market. The business will examine such areas as:

- the market share of its product
- future trends within the market
- strategies used by competitors
- changing consumer tastes and preferences.

There are two key elements to a situational analysis when presenting a marketing plan: an examination of the business/product life cycle and a SWOT analysis.



Source 7.3 The two components of a situational analysis

Product life cycle

Product analysis examines the current position of the goods and/or services that a business produces in the marketplace. Changing trends, innovation, product prices, sales and profit margins will impact on the success of a product within the marketplace, and this is something all businesses will experience. A business's product will often go through different phases over the course of its existence. This is known as the **product life cycle**.

There are four phases, or stages, to the product life cycle: establishment, growth, maturity and post-maturity (as outlined in Source 7.4).

When looking at the product life cycle, it is important to note that not all businesses will experience all four stages in the cycle. If a business is able to successfully adapt to changes within the environment in which it is operating, it will be able to avoid the final stage of decline. The marketing strategies that a business adopts will vary according to its position in the product life cycle.

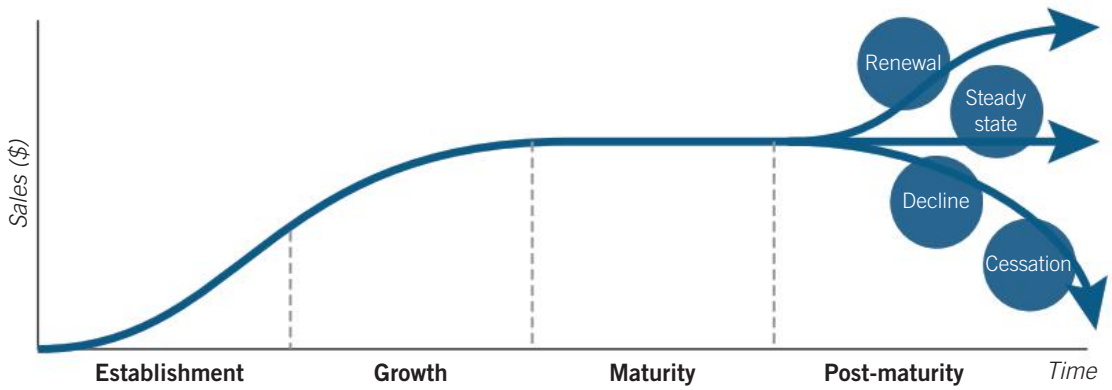
Establishment stage

The establishment stage of the product life cycle starts when the new product is first launched. Establishment takes time. Sales growth may be slow because the business is only beginning to establish awareness of the product in the market and needs some time to develop a loyal customer base.

Profits are limited because of the lack of revenue, while costs, which include fixed expenses (such as rent and insurance), are high. Management may decide to launch the product with a high price accompanied by limited promotional spending. The high price may assist in recovering some of the establishment costs and develop an image of product quality among consumers. The limited promotional spending will keep costs down. Consumers may be willing to try the product and are often prepared to pay the higher price for this privilege.

Product analysis Examines the current position of the goods and/or services that a business produces in the marketplace.

Product life cycle The different phases that a business's product/s will often go through over the course of its existence.



Source 7.4 The product life cycle

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However, limited expenditure on promotion could hinder the business as it attempts to gain market share. On the other hand, a business may launch a product with a low price to establish quick entry into the market and make considerable expenditure on promotion. This pricing strategy is known as penetration pricing (discussed in Chapter 8 in detail). Kmart has been successful in the use of this pricing strategy. Its 'Low Prices for Life' campaign has been effective in highlighting the brand's commitment to affordably priced homeware and essential products.

Growth stage

If a new product can begin to attract a core group of customers who display their loyalty to and satisfaction with the product by making repeated purchases, then the business will enter the growth stage of the product life cycle. The business's profitability will grow as sales expand. Attracted by opportunities for profit, competitors will enter the market. The marketing strategies of the business will also change. Businesses may choose to lower their price to deal with the increased threat of competitors in the market or consider the possibility of expanding their distribution channels to allow greater access by customers in areas where other competitors are showing signs of success. It is also expected that promotional costs will increase during this stage in a product's life cycle.

Maturity stage

The maturity stage is the period of the product life cycle when sales will begin to plateau. The business is faced with a steady income stream with limited prospects for growth. Both the business's product and competing products are readily available. Consumers now have considerable choice as to where to purchase the product. At this stage, the business must modify its marketing strategies to ensure continued success. During this stage, it is important that the business establishes a competitive advantage by differentiating its product from its competitors' products. This could include strategies of price differentiation, after-sales service, unique forms of promotion or making it easier for consumers to access the product. Many car companies sell vehicles in the maturity stage of the product's life cycle, and must use a range of strategies such as after-sales service to entice customers away from their competitors.

Post-maturity stage

The post-maturity stage is the final phase of the product life cycle. During this stage, key decisions will be made that will ultimately affect the long-term survival of the business and its product. By now, the product is established within the market. Increased competition and changing consumer preferences may create a need for change.

Business Bite

The concept of e-commerce has changed significantly over the past 20 years. Australia is currently ranked 10th in the world for its use of online platforms to purchase goods. Kogan is a business that has experienced exponential growth as an online retailer, providing customers with products ranging from electronics to groceries, insurance and finance. The use of a digital marketplace has helped Kogan to make everyday goods and services more affordable and accessible for consumers. According to the *Australian Financial Review*, the number of active Kogan customers grew by 36 per cent during 2020 as many consumers transitioned to online shopping with the e-tailer during the COVID-19 lockdowns.

Source 7.5 Digital marketplaces have become popular among many Australians.

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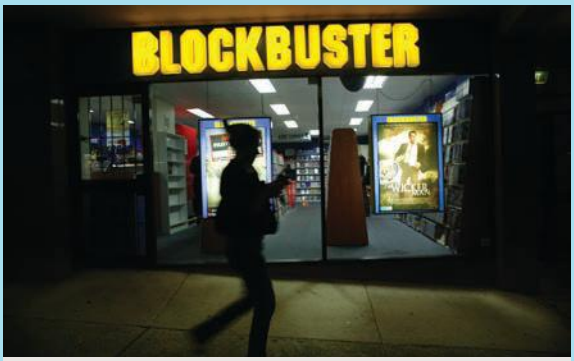
Business Bite



Source 7.6 A Blockbuster store in Sydney, 2007

At its peak in 2004, Blockbuster Video owned over 9000 video rental stores globally. However, technological advancement and the emergence of streaming services such as Netflix quickly saw Blockbuster's performance decline. In 2010, the business filed for bankruptcy, having accumulated over US$1 billion in debt.

During the post-maturity phase, the long-term future of the business will be dictated by one of four paths:

- decline
- renewal
- steady state
- cessation.

During the decline stage, the business faces a marketplace where there is increased competition and changes in the business environment. Its product no longer meets the needs of consumers and/or is considered to be outdated and irrelevant to their needs. Marketing strategies implemented by the business would aim at revitalising the product. Should these strategies prove to be unsuccessful in the marketplace, the closure of the business may be inevitable.

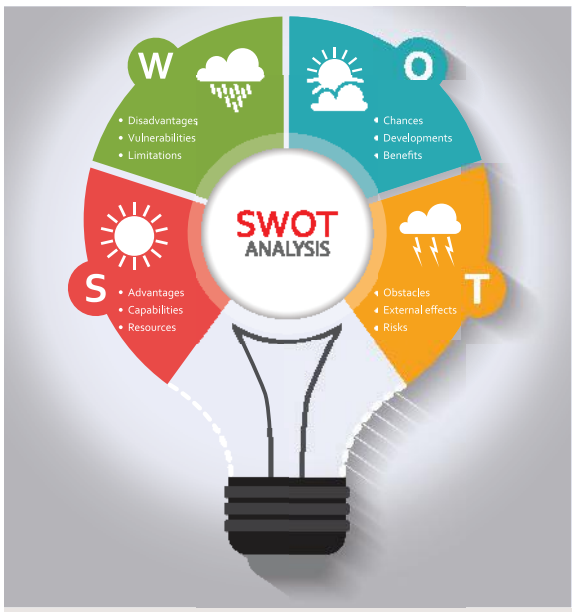
To restrict the impact of increased competition and to re-establish itself with a competitive edge, the business may look to revitalise its product. This is called the renewal stage. The business may alter the product's features or packaging and relaunch the product as it seeks to invigorate the image and perception of the product in the marketplace. Many businesses develop new promotional campaigns aimed at sustaining interest in a particular brand. Alternatively, new strategies may be developed to take the product to a new audience.

Ethical Spotlight 7.1

Should a business make use of strategies similar to those of its competitors if it found they were more successful than those the business is currently using?

SWOT analysis

A SWOT analysis is used to examine the strengths and weaknesses of a business and the opportunities and threats that lie within its external environment. By working through this process, a business is able to determine the most suitable strategies to rectify the organisation's weaknesses and how to best handle the possible opportunities and threats.



Source 7.7 SWOT – strengths, weaknesses, opportunities, threats

Strengths and weaknesses

The strengths and weaknesses of any business are factors that are developed and controlled from inside the business. Questions to consider

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when examining a business's strengths and weaknesses may include:

- Does the business have a good reputation among its stakeholders (customers, creditors, employees and suppliers)?
- Does the business have highly skilled, well-trained, motivated staff who can achieve the organisational objectives of the business?
- Is the business financially stable and does it have the necessary funds to finance opportunities to enhance its strengths, improve its weaknesses, take advantage of possible opportunities and deal with threats?
- Is the business recognised for the high quality of its products and its ability to meet changing trends within the marketplace?

Opportunities and threats

For any business, the opportunities and threats are factors that are developed from the external business environment. The business has very limited control over how or when these issues arise.

Questions to consider when examining a business's opportunities and threats could include:

- What is the degree of competition in the marketplace and does this impact on the business?
- To what extent is the business subject to changes in its external business environment (such as interest rates, the economy, wage growth and industry assistance) and do they provide avenues for the business to grow?
- Are competitors reacting to the business's products by producing less expensive substitutes?
- Is the competitors' performance sufficient to place pressure on the business to reduce its cost base?
- To what extent is the business responding to changing tastes and preferences within the marketplace?

For a business to be effective and successful, it should constantly work to consider the needs of its consumers. Business goals must be developed in a way that, if achieved, will not only benefit the business but also ensure consumers are satisfied with their purchase of the business's product. It should consider the impact that changes in its external environment will have on the future operations of the business and how these changes will influence the marketing function of the business.

Source 7.8 Businesses must remain aware of threats from the external business environment, such as less expensive substitutes.

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Activity 7.1
Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Describe the key elements contained in a SWOT analysis.
2. Identify a large business with Australian-based operations and complete a SWOT analysis for this business.
3. Discuss two strategies that a business wanting to enter the renewal stage may implement.

Digital quiz
Please see the Interactive Textbook to access digital activities.

7.3 Market research

Market research is an essential component of any business activity. It allows a business to gather information that is relevant to its needs and those of its clients. It provides businesses with data so that informed and intelligent decisions can be made regarding various issues. When conducting market research, it is important that the business first determines its information needs; that is, the business should have some idea about the type of information it is looking for. It could vary from customer profiles or brand awareness through to attitudes towards certain new products. Once its information needs are established, the business can determine the most appropriate research method.

Source 7.9 Collecting data can provide valuable insights into the behaviours of the target market.

Data collection (primary and secondary)

There are two types of data that an organisation may seek to gather: primary and secondary.

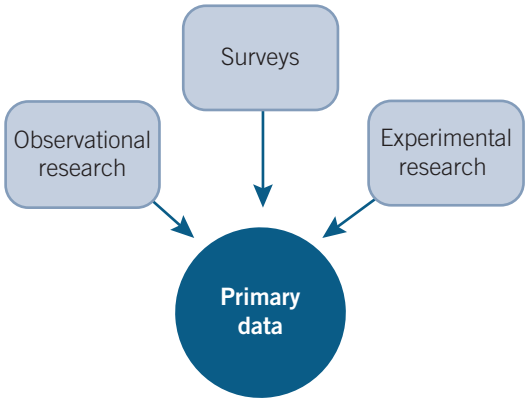
Primary data

Primary data refers to information that is collected for the specific purpose for which it will be used. For example, if Cotton On conducted research to determine the age bracket of the customers visiting a specific store, the data it gathered would be primary data. It would be primary data because it was gathered only to fulfil the specific purpose of the research (that is, to find out the age profile of Cotton On customers).

There are three common types of market research that can be used to collect primary data:

- observational research
- surveys
- experimental research.

Observational research is when primary data is gathered through the observation of a relevant group of people, their actions and how they respond to certain situations. For example, researchers for a department store may observe the number of people who stop to look at a display located in a particular area of the store and their responses to the display.



Source 7.10 Types of market research used to gather primary data

Primary data Information that is collected for the specific purpose for which it will be used.

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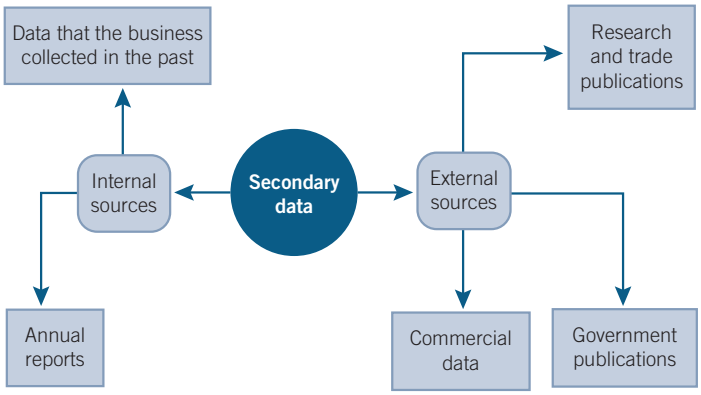
Surveys involve gathering primary information by asking a number of people the same questions. These questions could be about the respondents' knowledge, attitudes, preferences and buying behaviour.

Experimental research is used to examine how people react to different products and features. For example, two versions of the one movie may be shown to different test audience groups. Each version is the same except for the ending. This allows the film company to determine which ending receives a better response from the audience.

Secondary data

Secondary data refers to information that already exists, having previously been collected for another purpose. Cotton On, for example, may use the information that it collected from earlier market research to make comparisons with current data. It may want to study the data collected from past research into the age profile of its customers and compare it with the current data. It may also want to examine previously collected data about the types of purchases and amounts of money spent by these customers. Given that this information already exists and was collected for another purpose, it is an example of secondary data.

Secondary data Information that already exists, having previously been collected for another purpose.



Source 7.11 Sources of secondary data, with examples

Businesses may access secondary data from internal or external sources.

Internal sources of secondary data are those within the business itself. Data from these sources has been collected by the business. This data can include annual and financial reports, prior research, past surveys and previous sales figures. Businesses may use internally sourced data to make comparisons between past and present results. For example, if a business sought to compare its current sales performance against that of previous years, it could obtain data collected from those years. Changes in profitability from one year to the next could be examined by looking at previous reports describing conditions under which the business was operating at that time.

External sources of secondary data are sources that exist outside the business. This data has been collected by other organisations or individuals. If the business wants to use this data, it may need to pay the organisation that owns the data. However, many forms of secondary data from external sources are readily available to interested parties at no cost. These include government publications, generally from the Australian Bureau of Statistics, and books, magazines and the internet.

Business Bite

Loyalty cards have increased in popularity among Australian businesses. Supermarket giant Woolworths uses its Everyday Rewards program to collect data about each shopper's purchasing behaviour. These insights are extremely valuable for Woolworths, which uses this primary research to create personalised advertising material that is sent to its customers via email. Currently, Woolworths has over 12 million Australian customers who are part of its loyalty program.

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Data analysis and interpretation

After a business has gathered the information it requires, it must then make some meaning of it. The business will attempt to analyse and interpret the data so that management can gain a better understanding of the impact of the data on the operations of the business. Once this has been achieved, management is able to determine the most appropriate course of action to take.

Review 7.1

Comprehension and research

1 Outline the difference between primary and secondary data.
2 Explain how loyalty cards are a form of primary data collection.

7.4 Establishing market objectives

The goals of a business provide the framework for it to develop objectives that aim to achieve the goals. In essence, the objectives guide the activities and operations of the business. It is important that the objectives be flexible so they can be adapted to the changing nature of the business environment.

SMART approach to setting objectives

Businesses generally adopt a SMART approach to setting objectives; that is, an objective needs to be:

- **S** = specific – the objective needs to be clear and precise and relate to specific elements of the business.
- **M** = measurable – the business needs to develop controls that are effective in measuring the extent to which the goal has been achieved.
- **A** = achievable – the business needs to have the financial and human resources required to achieve the goal.
- **R** = realistic – the objective should not be based on unreasonable expectations; that is, it must be possible for the business to achieve the objective.
- **T** = time – the time frame within which the business hopes to achieve the goal must be determined.

Source 7.12 The SMART approach to setting objectives

Marketing objectives

There are three key marketing objectives that most businesses may adopt: increase market share, expand into new geographic markets and expand the product range.

An effective business is one that develops goals and objectives that relate to the specific needs of its organisation.

Increase market share

Market share refers to the percentage of total sales a business has compared with that of its competitors in a particular market. The purpose of attempting to increase the market share of a business is to increase the business's sales and maximise profitability.

Achieving this objective allows the business to become stronger and more dominant in the marketplace. JB Hi-Fi, which offers low everyday prices and emphasises value for money, is now recognised as a significant force in the Australian electronics market. It has expanded into the mobile phone plan market. JB Hi-Fi now has 300 stores across Australia, eclipsing Harvey Norman and The Good Guys.

Expand into new geographic markets

Some businesses may decide to expand the areas where their goods and services are distributed. This allows a business to increase its sales but, more importantly, allows the brand or product to achieve a higher level of awareness among customers. In recent years, Australia has experienced an increase in the number of premium streetwear brands. For example, Culture Kings opened in 2008 on the Gold Coast and gained a reputation for

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selling sought-after and exclusive streetwear collections. Its stores play live music and are often frequented by celebrities. The business has expanded into new geographic markets with eight stores nationwide.

Source 7.13 Culture Kings offers customers a unique shopping experience with competitions and live DJs.

Expand the product range

The extension of a business's product range presents the business with a number of opportunities. Providing a wider range of products may allow the business to target new markets in order to attract consumers who have not previously purchased its brands. The new products may not be substantially different from the existing brands, but will be promoted and distributed in a way that reaches new markets. Daimler AG, for example, owns numerous car brands, including Mercedes-Benz and Smart. The business alters its marketing strategies for each brand to suit the diverse needs of the respective target markets. By doing this, Daimler AG seeks to broaden its customer base.

Source 7.14 Daimler AG uses a wide range of vehicles to ensure a broad customer base.

Review 7.2

Matching

Answer this question on paper or in the Interactive Textbook.
The objectives and explanations below are in the wrong order. Demonstrate your understanding by matching each objective with the correct explanation.

Objective	Explanation
Expand into new geographic markets	Broadening the variety of products sold in order to attract a new group of customers
Expand the product range	Increase the percentage of total sales the business has compared with its competitors in a particular market
Increase market share	Expand the areas where the products are distributed

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7.5 Identifying the target market

A target market is a group of consumers for whom a particular product has been developed. The business hopes that these people will buy the product when it is made available in the marketplace. Some products appeal to all consumers, while others have very limited appeal.

To identify the appropriate target market for its product, a business needs to understand the nature of consumer markets. Consumer markets are the most recognised market within the business environment. They are where businesses sell their products directly to consumers. Often the business would have purchased the products from other businesses not dealing in the consumer market. For example, Sony and Panasonic are manufacturers of many popular home entertainment appliances. While they manufacture the items, stores such as The Good Guys, Bing Lee and JB Hi-Fi act as the market where consumers can access these brands.

Types of consumer markets

Consumer markets can be broken down into a number of different categories.

Mass market

The mass market consists of all consumers (that is, people of all genders, ages, geographic locations and income levels). Products targeting the mass market are not aimed at a specific buyer group. Instead, mass market products appeal to all consumers. We all consume these products and there are limited strategies a business can use to make its products different from those of competitors. Some of the ways the business can differentiate its products are through packaging, brand loyalty, price or by offering extended warranties. It is in these areas that a business operating in the mass market would attempt to gain a competitive advantage.

Market segments

A business may choose to target its products to a specific market segment (that is, one area of

Business Bite

Korean car manufacturer Kia first entered the Australian market in 1996. Despite its early failures, the business has been highly successful at capturing market share from its competitors Toyota and Honda.

Kia has been effective at creating a wide range of vehicles to suit the different needs of its market segments.

- The Kia Rio is a small vehicle targeting younger females as well as empty nesters and retirees who want a vehicle suited to the urban environment. The vehicle provides high fuel efficiency as well as a 5-star safety rating.
- The Kia Stinger is a high-performance sports sedan aimed specifically at young professional males in the 25–44-year-old demographic. The brand aims to attract customers who have a willingness to pay for style and performance. The vehicle contains several luxury amenities, including a 3.3-litre twin-turbo engine.
- The Kia Sorento is a large SUV that is suited for families. The vehicle contains a stylish exterior while providing plenty of seating for large extended families. The oversized boot and diesel engine cater to families who enjoy holiday and camping trips.

Source 7.15 Kia has expanded its product offerings to broaden its appeal to numerous market segments.

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a particular market). A business can decide to segment its market to ensure that appropriate promotional and pricing strategies are developed.

Niche markets

Each market segment consists of a number of smaller markets, called niche markets. A business targeting a niche market has a specific, narrow customer base. For example, Well Naturally developed its range of sugar-free chocolate bars in response to the growing number of consumers who sought healthier options.

The Body Shop is an international cosmetics business with operations in Australia. The business has committed to developing products that are free from animal testing. The Body Shop targets a growing niche of consumers who are ethically minded and socially conscious.

Activity 7.2
Develop a mind map

Construct a mind map of the three different types of consumer markets. For each market, provide a simple definition and two examples of businesses and their products operating within these markets.

Digital quiz
Please see the Interactive Textbook to access digital activities.

7.6 Developing marketing strategies

Once the strategic goals of a business have been set and the organisation has established specific market objectives, the business must develop appropriate marketing strategies. The success of these strategies is crucial if the business is to achieve its objectives.

The marketing mix

Developing marketing strategies involves using the marketing mix. It is referred to as a mix because the strategies often consist of a combination of four elements known as the 4Ps: product, price, promotion and place. In recent years, the traditional marketing mix has been extended and refined, with the 7P model gaining increased popularity. We will look briefly at the 4Ps here: all 7Ps are covered in further detail in Chapter 8.

Source 7.16 The 4Ps that make up the marketing mix

Product

Product is the good or service the business intends to provide in the marketplace. The business must consider the product's quality, image, logo and packaging and where the product will be positioned against competitors' products (for example, whether the product will be upmarket or a discount product). Consideration of this will also include decisions about the benefits attached to purchasing the product, such as warranties, after-sales service and maintenance.

Price

Price is the cost to the consumer of buying a good or service. When determining an appropriate price for a product, the business must consider its cost to the business (production and distribution), the desired profit margin and the pricing strategies used by competitors. The way consumers react to this price will also be an influence. A low price may encourage sales, but some consumers will then perceive the product to be of poor quality.

Promotion

Promotion is the process of creating and maintaining consumer awareness of, and interest in, a particular product. It is hoped that the various

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forms of promotion used by the business will convince consumers that they 'need' the product, which will ultimately translate into purchases.

Traditional forms of promotion include radio, television and newspaper advertising. Innovative methods include social media platforms and gaming apps.

Place

The place element of the marketing mix is the methods of distribution and the availability of the good. When a business is considering this element, it needs to decide where the consumer will be able to purchase the product. Issues such as storage, transportation and costs of distribution must also be considered. While some goods are readily accessible to the public, businesses may restrict the availability of others in order to create an image of prestige.

7.7 Implementation, monitoring and controlling

Once the marketing plan has been devised, a business must implement the strategies contained in the plan. **Implementation** is the process of organising the activities of the business to achieve its goals. This means managers must now act on their decisions related to the new marketing plan. When a business implements its marketing plan, it is putting into practice a range of strategies. This could include the release of new products and advertisements, the opening of new stores and changes to its pricing. Once the strategies are implemented, the business can then measure their effectiveness.

It is important that a business develops methods that management can use to **monitor** the extent to which the implemented strategies are achieving the desired outcomes. Businesses monitor the progress of their marketing through controlling. **Controlling** is the process of comparing actual results with the results that the business had planned to achieve. It allows management to determine whether the organisation is achieving its objectives and the reasons why the objectives are, or are not, being met.

Developing a financial forecast

Like other parts of the business, the marketing team needs to make financial forecasts when planning activities, to provide a level of confidence that the marketing expenditure will be justified by results.

The business's operating budget will include a forecast of expected revenue, and the marketing team may have had input into this, in areas such as determining the pricing strategy. The marketing manager may decide to set the budget for marketing campaigns as a percentage of the forecast revenue. Or they may decide to further refine the forecast revenue, to identify how

Implementing The process of organising the activities of the business to achieve business goals.

Monitoring The process of determining the extent to which the implemented strategies are achieving the desired outcomes.

Controlling The process of comparing actual results with the results that the business had planned to achieve. Businesses make revisions to the marketing plan when results have not been met.

Source 7.17 A business can monitor and control the effectiveness of its marketing through methods such as sales analysis.

Activity 7.3
Role-play

With a partner, role-play a scenario in which you assist a customer with his or her enquiries about a particular product. The discussion between you and the customer should include:

- a description of the product's features
- where the product is positioned against those of its competitors
- the price of the product
- factors influencing the price of the product
- where the product is available.

Video 7.1 Reviewing and evaluating marketing strategies

Digital quiz
Please see the Interactive Textbook to access digital activities.

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Sales analysis An examination of the sales of a particular product among different customer groups, by sales representatives and during various times of the year.

Market share analysis An examination of the sales performance of a business and its comparison with that of its direct competitors.

much can actually be attributed to marketing activity: this can be very difficult to estimate, as there are many external and internal factors that will ultimately have an impact on the final revenue.

The marketing manager will also forecast the costs of the marketing plan. This needs to cover all elements of it. For example, a television advertising campaign will involve the cost of having the advertisements made, and also the amount paid to the networks to have them shown. The size and format of a campaign will often be at least partially driven by the amount it is likely to cost, so if initial cost estimates of a planned television campaign are too high, it may be changed to a radio campaign, or print. In contrast to the revenue forecasts, it is generally possible to be quite accurate when working out the costs of a well-planned marketing campaign. However, there is always the possibility that plans may change unexpectedly, such as if it becomes necessary to respond to a competitor's campaign.

Comparing actual and planned results

The three common forms of analysis and control used by a business when comparing actual and planned results are:

- sales analysis
- market share analysis
- marketing profitability analysis.

Sales analysis

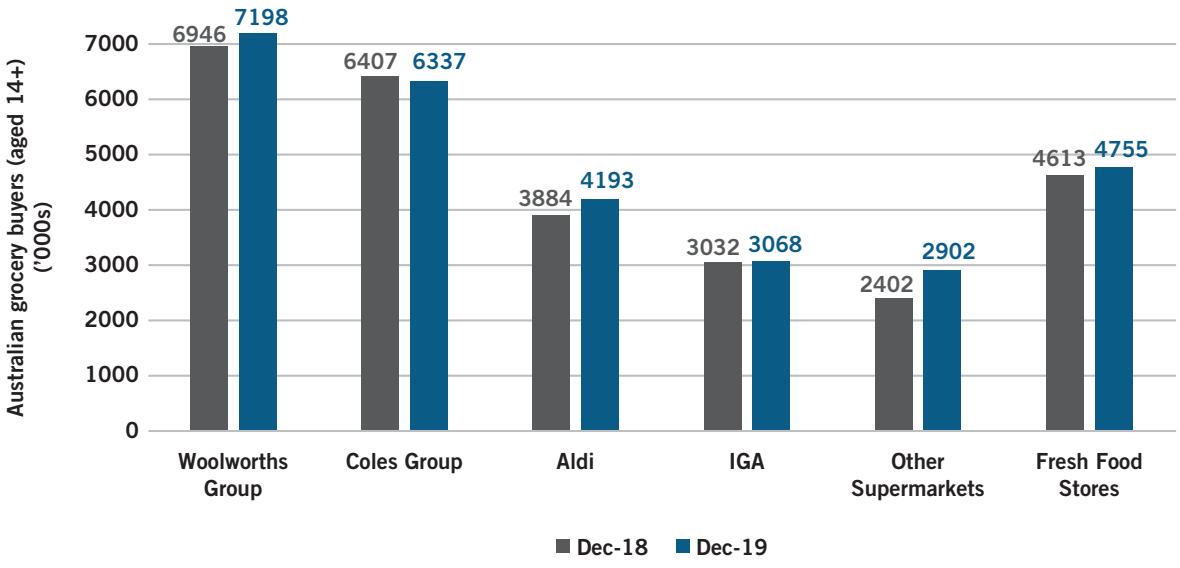
Sales analysis examines the sales of a particular product among different customer groups (age, income and location), sales representatives and times of the year. When a business has product depth (that is, when it has a range of products that appeal to a number of markets), it can use sales analysis to determine which product is performing strongly and whether one product is being sold to the detriment of another.

By comparing actual sales against those forecast, a business is able to examine how effective its marketing strategies have been. It would also take into account external factors that would have caused the differences, such as changes to interest rates, employment conditions, consumer confidence and political concerns.

Market share analysis

Market share analysis examines the sales performance of a business and compares it against that of its direct competitors. It allows management to determine whether the marketing strategies implemented by

Source 7.18 Market share of Australian supermarkets ('000s)



Source: Roy Morgan Single Source Australia, January 2019 – December 2019, *n* = 11 045. Base: Australian grocery buyers aged 14+ (weighted to Australian households).

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the business have increased the number of customers the business has and the extent to which these customers have come from competitors. Market share analysis is a very useful tool in examining the strengths and weaknesses of a business's marketing plan in comparison with the plans of its main competitors.

Marketing profitability analysis

Marketing profitability analysis is the process of evaluating the financial (such as profit and sales) and non-financial (such as brand awareness and customer satisfaction) benefits that have been achieved by a specific marketing plan against the costs of implementing the plan. This form of control is based on the concept of cost–benefit analysis. It involves asking whether the financial and non-financial benefits achieved by a marketing plan can be justified based on the cost of implementing the plan.

Revising the marketing strategy

While monitoring and controlling the marketing plan is essential, the business must also adopt revised strategies, when necessary, to ensure its continued success. The extent to which the marketing strategies are altered will depend on whether the business has achieved its objectives, as well as on relevant changes in the business environment.

Marketing profitability analysis The process of evaluating the financial (such as profit and sales) and non-financial (such as brand awareness and customer satisfaction) benefits that have been achieved by a specific marketing plan against the costs of implementing the plan.

Review 7.3

Discussion

Answer these questions on paper or in the Interactive Textbook.

1. Outline the benefits of developing a financial forecast.
2. Explain how a business can revise its marketing plan.

Business Bite

The global pandemic forced many businesses to revise their marketing plans and adjust to consumer needs. Raise, an online gift card marketplace based in the United States, adapted its marketing activities to better connect with its customers. Traditionally, travel gift cards are a major source of revenue for the business. With travel restrictions in place, Raise altered its marketing strategy by selling more everyday essentials, such as home office equipment, groceries and household appliances. The business continued to monitor consumer needs and amended its strategies accordingly.

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Chapter summary

Planning is a central activity of any business. It allows a business to examine its current position in the market, consider opportunities to strengthen that position and determine the most effective method of implementing the required changes.

The elements of a marketing plan are:
- the executive summary
- the situational analysis.

The purpose of market research is to:
- establish market objectives
- identify the target market
- develop marketing strategies
- implement, monitor and control.

The executive summary provides a brief description of current issues that are facing the business and an overview of the main goals and recommendations that will be presented in the plan.

The situational analysis provides the firm with an opportunity to examine issues the business is currently facing within the market. The two key elements to a situational analysis are:
- product life cycle
- SWOT analysis.

Market research is an essential component of any business activity. It allows a business to gather information relevant to its needs and those of its clients. It provides businesses with data, ensuring they can make informed decisions.

When conducting market research, it is important that a business determines what type of information it needs and how this information will be used to assist the business.

Primary data refers to information that is collected for a specific purpose. Types of market research that can be used to obtain primary data include observational research, surveys and experimental research.

Secondary data refers to information that already exists somewhere, having already been collected for another purpose. It can be either internal or external.

Once a business has gathered the information it needs, it must analyse and interpret the information so it can understand the impact of the data on the operations of the business.

Market objectives need to be SMART (that is, specific, measurable, achievable, realistic and have a time frame).

The general market objectives of a business are to increase its market share, expand into new geographic markets and develop its product range.

A target market is a group of customers for whom a business has developed a product. The three categories of target markets are:
- mass markets
- market segments
- niche markets.

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Developing marketing strategies is the process of developing a product that meets the needs of consumers and then implementing a series of promotional, pricing and distribution strategies to encourage the consumer to purchase the product.

The traditional marketing mix is made up of four key elements: product, price, promotion and place.

Financial forecasts of revenue and expenditure should be made before implementing a marketing plan.

Monitoring and controlling a marketing plan involves comparing the actual and planned results to see whether the organisation is achieving its objectives, and determining the reason for this.

The three common controls used by businesses to monitor their marketing plan are:

- sales analysis
- market share analysis
- marketing profitability analysis.

End-of-chapter tasks

Chapter revision task

Trendi Levendi is an up-market men's tailor. It is well established in the Sydney fashion industry and boasts a reputation of providing high-quality products to men of all ages and sizes.

The rise of online shopping, express shipping, competition from overseas and changing customer preferences are forcing Trendi Levendi to reconsider its marketing plan, as sales have fallen.

Use the information above to answer the following questions.

1 Identify the stage of the product life cycle that Trendi Levendi is in.

2 Outline the major threats impacting on the business.

3 Explain the types of market research the business can conduct to identify its target markets.

4 Recommend two marketing strategies that the business can adopt to improve sales.

5 Discuss how the business can monitor and control the effectiveness of its marketing plan.

Multiple-choice questions

1 Boston owns a sports clothing business. He conducts a SWOT analysis, which indicates that the size of the market has reduced and there is a high turnover of staff.

What two components of a SWOT analysis are these a feature of?

A A threat and an opportunity
B An opportunity and a weakness
C A weakness and a strength
D A weakness and a threat

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2 Jim owns a large distribution company that supplies meat to restaurants, cafes and clubs. He uses a database to monitor the spending habits of his clients.

What is this an example of?

A Secondary research to determine target market
B Primary research to determine product life cycle
C Primary research to determine target market
D Determining information needs

3 What do market segments allow a business to do?

A Develop and sell its product to a number of different markets
B Identify the characteristics of people who will most likely purchase its product and then develop appropriate promotional and pricing strategies
C Choose a price that appeals to a select group of customers
D Examine the purchasing trends of its target market

4 What is the name given to the core group of customers to whom a business primarily promotes and prices its products?

A Target market
B Market segment
C Niche market
D Mass market

5 Which statement best describes a product targeted at a niche market?

A A product with high turnover and a large consumer base
B A product with appeal to large groups of customers
C A specialised product with appeal to one segment of a market
D A product with little or no differentiation between it and competing products but with wide appeal

6 Panos Almond has just released a new type of gluten-free brownies. Which market is Panos Almond targeting?

A Mass market
B Differentiated market
C Intermediate market
D Niche market

7 Stomo's Pies is a gourmet pie business that distributes to pubs, RSL clubs and schools. What market is Stomo's Pies operating in?

A Industrial
B Consumer
C Mass
D Intermediate

8 Before the launch of its new cookie range, DK Bizcut developed four variations and invited customers to try each one. Customers were surveyed and their feedback was used to decide on the product to sell.

This is an example of:

A relationship marketing.
B experimental research.
C observational research.
D secondary research.

9 The first step in the market research process is:

A data collection and analysis.
B data interpretation.
C determine information needs.
D study consumers' behaviour.

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10 What do external sources of secondary research refer to?

A Data that has been collected by the business for a specific purpose
B Data that has been previously collected by the business and is used for a different purpose
C Data that is not collected by the business and is to be used for a specific purpose
D Data that has not been collected by the business and is used for a variety of purposes

Short-answer questions

1 Describe two indicators that a business can use to measure the success of its strategies.

2 Explain why it is important for businesses to evaluate their marketing objectives.

Extended-response question

Assess the effectiveness of the marketing process in achieving marketing objectives.

Digital resources

Visit the Interactive Textbook to access:

- interactive chapter Scorcher Quiz
- videos, image galleries and other extra materials.

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8 Marketing strategies

Chapter objectives

In this chapter, students will:

- identify how marketing strategies cater to different segments of the market
- investigate issues around products, pricing and promotion
- analyse the effectiveness of distribution channels
- evaluate the role of global marketing.

Key terms

- behavioural segmentation
- branding
- competitive positioning
- cost-plus pricing
- demographic segmentation
- distribution channels
- exclusive distribution
- geographic segmentation
- intensive distribution
- loss leader
- market segmentation
- penetration pricing
- place
- positioning
- price
- price skimming
- product-deletion pricing
- psychographic segmentation
- relationship marketing
- selective distribution

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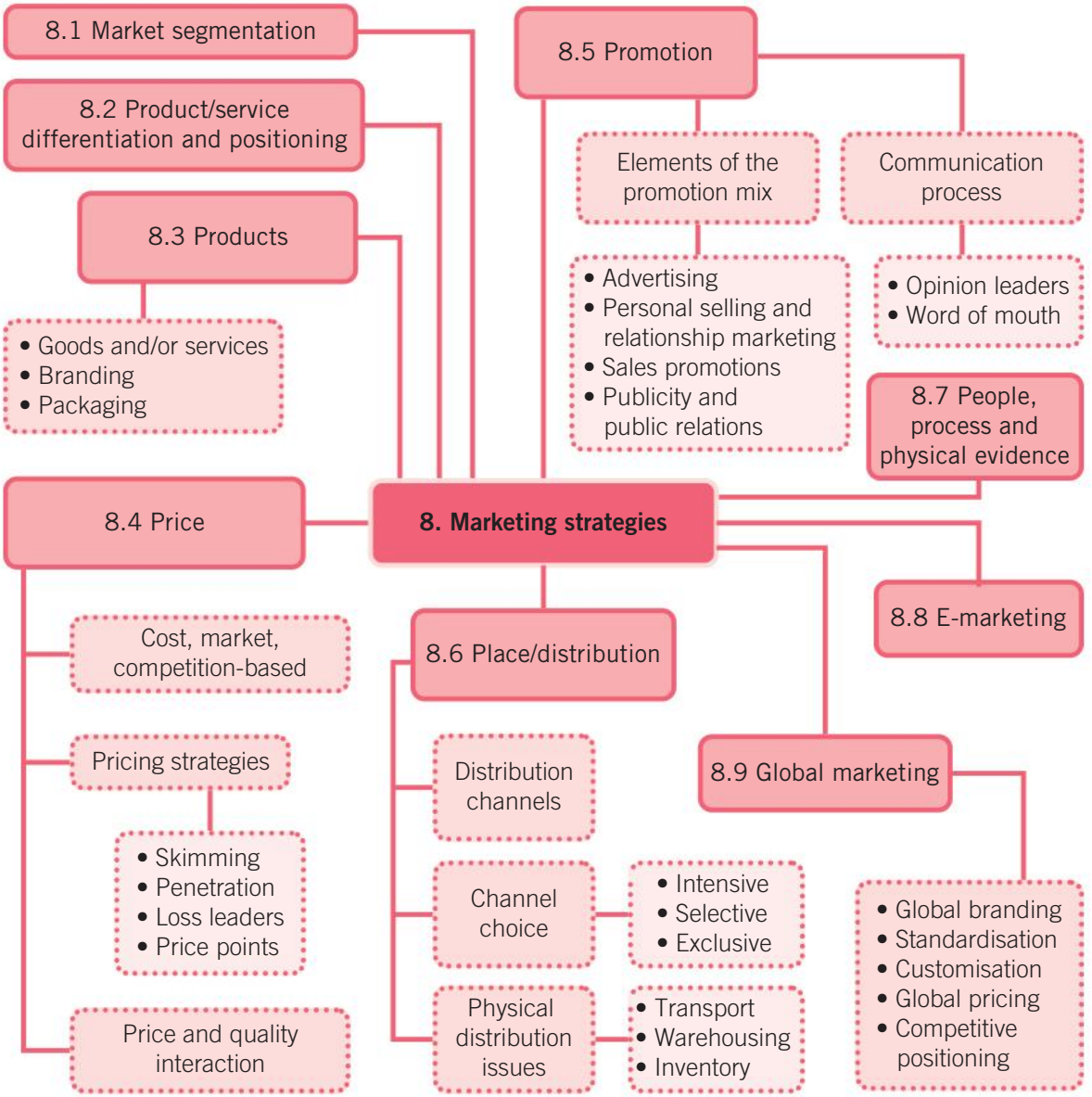
8.0 Introduction



Source 8.1 Marketing strategies concept map

When devising a marketing strategy, it is important that a business has a clear understanding of which group of people is likely to buy its products (that is, who its target market will be). Once this has been established, the organisation will develop appropriate promotional and pricing strategies that cater to the needs of this target group. The business will also need to consider appropriate locations to sell the product.

When devising marketing strategies, businesses traditionally consider a marketing mix with four elements, known as the 4Ps: product, price, promotion and place (or distribution). In recent times, however, it has become clear that there are more elements that have equal importance, so now businesses work in terms of the 7Ps, with the additional three being people, process and physical evidence.

Video 8.1 The 7Ps of marketing strategies

Digital quiz
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8.1 Market segmentation

The wide variety of goods and services that businesses produce is a reflection of the diverse range of tastes, preferences and attitudes of consumers. In fact, only a limited number of products appeal to all consumers, irrespective of age, income, gender or cultural background. As we have seen, these products form part of the mass market – they cater for the needs of the whole market, and for all types of consumers. Factors such as age, gender and income are not important. Examples include electricity, gas, rail services and postal services. **Market segmentation** is the process of dividing customers into smaller groups based on characteristics. It allows businesses to focus their efforts and resources on a section of the market. By focusing on a particular target group, a business is able to identify the specific needs of this group and tailor its marketing plan accordingly. It would consider the features that consumers of this target group would be looking for in a product, the appropriate promotional strategies to generate awareness of and sustain interest in the product, and the most suitable pricing policies and distribution channels. There are a number of methods of market segmentation.

Market segmentation The process of dividing customers into smaller groups based on characteristics.

Geographic segmentation The process of dividing a market or customer group into smaller markets based on different geographic locations, such as nations, states or local government areas.

Geographic

Geographic segmentation is the process of dividing a market or customer group into smaller markets based on different geographic locations, such as nations, states or local government areas. A business may choose to operate in specific geographic areas so it can focus on exclusively meeting the needs and wants of people in those areas.

This presents the business with an opportunity to adjust its marketing plan to suit the buying behaviours of consumers in specific geographic locations. McDonald's India, for example, does

Source 8.2 The 7Ps of the marketing mix

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Source 8.3 McDonald's India does not use any beef products.

not use beef or any beef-related product. This is because of the spiritual and religious beliefs of India's predominantly Hindu population.

Similarly, McDonald's Australia, KFC and Subway have all adopted halal menus across western Sydney. Halal is a process of preparing foods to comply with Islamic traditions and beliefs. These stores have done so to cater for the higher number of Islamic customers within their areas.

Demographic

The demographics of a customer group refer to the characteristics of the group's members, such as their age, gender, income, family size and level of education. **Demographic segmentation** is one of the more common forms of market segmentation. It most often includes consideration of age, gender and income.

Source 8.4 Some products are marketed to appeal to specific age groups.

Age

Consumers will demand different products at different stages of their lives. Therefore, the marketing strategies used by a business will need to incorporate features that appeal to specific age groups. Contiki Travel Tours provides adventure holidays that cater for adults aged 18 to 35. Travellers 40 years and over may prefer to use tour groups such as Trafalgar.

Demographic segmentation The process of dividing a market into smaller markets based on customers' age, gender, income, family size and level of education.

Business Bite

Many brands have been successful at using various marketing strategies to target different segments. The personal hygiene industry has traditionally used this to great effect. Rexona, the world's leading deodorant company, segments its consumers into two main groups: men and women. While there are no physical reasons why customers should buy gender-specific deodorant, Rexona has developed specific male and female ranges. Packaging, labels, names and colours have been designed to appeal to the different segments.

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Gender

Market segmentation based on gender has been widely used by businesses for a range of products, including clothing, magazines, soft drinks and motor vehicles. It aims to break down the market of a product based on gender influences. Some products and services are marketed in a way that will have more appeal to either females or males.

Income

Income influences the types of goods and services people buy. Some businesses develop products aimed at high-income earners who have the capacity to purchase luxurious goods. Certain car manufacturers, clothing designers and service providers use this form of market segmentation to sell their products. It allows them to decide on the most appropriate promotional and pricing campaigns and the suitable location for their business.

While having appeal to all income groups, discount department stores (such as Big W and Kmart) have been successful in promoting their stores as providing value for money. This would have considerable appeal to low- to middle-income earners.

Business Bite

Source 8.5 Rolex markets its watches towards high-income customers.

Rolex is a luxury watch manufacturer based in Switzerland. Its watches are crafted using the finest raw materials and assembled with great precision. Rolex's high-quality timepieces are aimed at individuals with a high income and socioeconomic status. The company uses an exclusive distribution channel, with its Sydney store located in Martin Place. This area is renowned for having high-earning consumers.

Psychographic

Psychographic segmentation allows a business to segment the market into different groups based on consumers' lifestyles, personalities, values and interests. For example, major electronic retailers such as JB Hi-Fi divide their store based on the category of products they sell. Sections of the store are dedicated to displaying TV units and kitchen appliances, while other areas specialise in gaming consoles for video game enthusiasts. The store layout reflects the wide range of interests held by the community.

Psychographic segmentation The process of dividing a market into smaller markets based on consumers' lifestyles, personalities, values and interests.

Behavioural segmentation The process of dividing a market based on people's knowledge of, attitudes towards and use of a product.

Behavioural

Behavioural segmentation is the process of dividing a market based on people's knowledge of, attitudes towards and use of a product. When using this form of market segmentation, a business may consider four factors. These factors are discussed below.

Purchase occasion

The business will consider when a customer is most likely to purchase its product. Florists, for example, will vary their promotional and

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pricing strategies throughout the year to suit the significant occasions when people commonly buy flowers and to target the group who usually buy the flowers for the particular occasion. For instance, marketing strategies leading up to Valentine's Day will target men, whereas strategies for Mother's Day may aim to appeal to children and fathers, as they commonly buy flowers for this occasion.

Benefits sought

An understanding of the benefits consumers seek from a purchase is an important facet of behavioural segmentation. Businesses can divide the market according to what customers want from a product. This could apply to millennial consumers who have a strong desire for speed and convenience, which led to the growth of many food-box delivery services such as HelloFresh and Marley Spoon.

Usage rate

Usage rate is a factor influencing this form of market segmentation. It allows a business to differentiate its customer base by establishing how often customers use the business's good or service. Internet and NBN providers have adopted this strategy by offering different data and download packages depending on a consumer's level of usage.

User loyalty

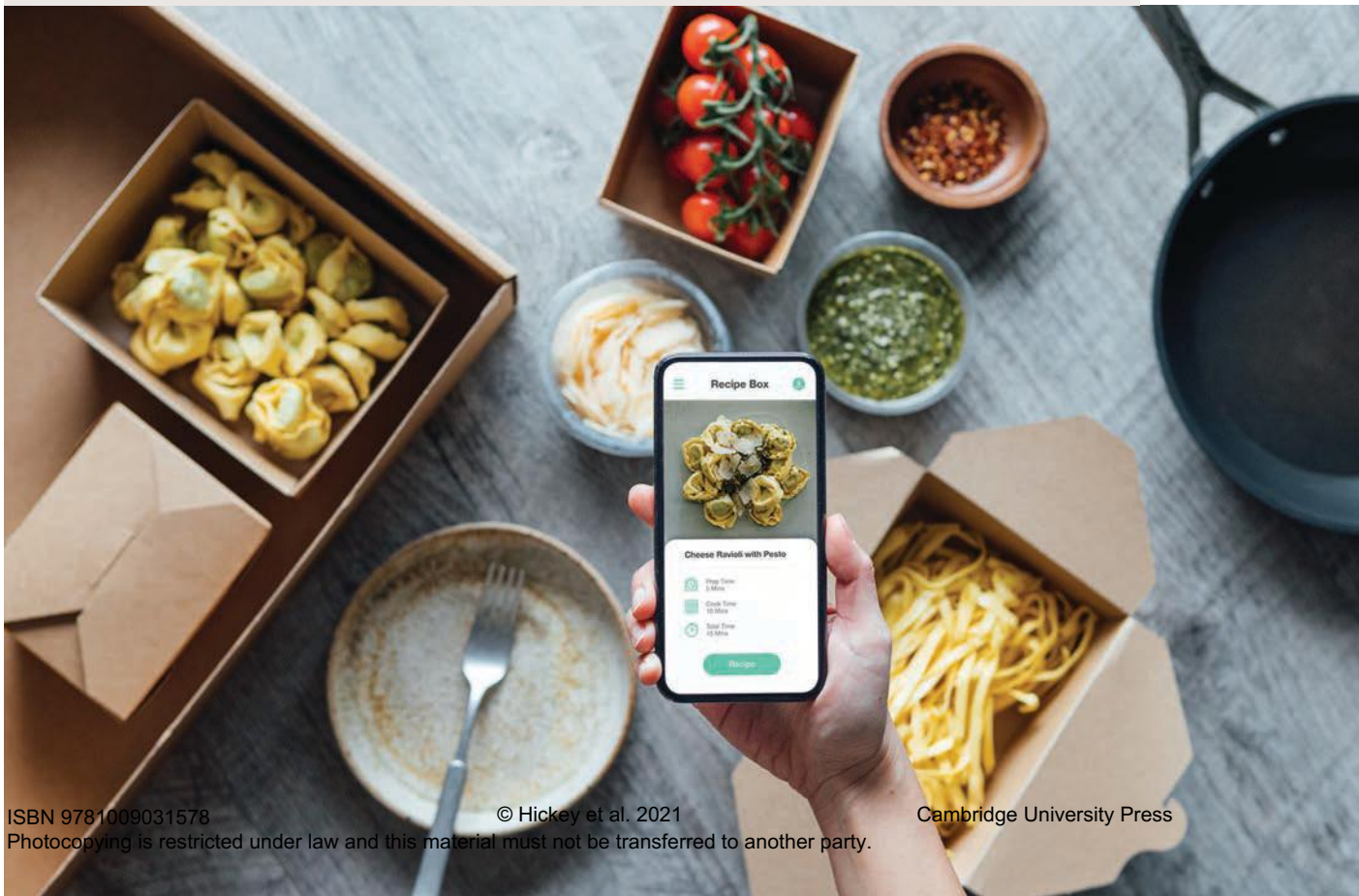
Relationship marketing is an important part of any business. It provides an opportunity for businesses to develop a loyal customer base. Businesses attempt to develop strategies that will establish and maintain customers' loyalty towards the business and its products. Once this loyalty is established, the business rewards its customers with vouchers, invitations to special sales events and discounts on specific products. Credit card rewards schemes, the Everyday Rewards program from Woolworths as well as Flybuys from Coles are examples of such strategies.

Activity 8.1
Summarise

Create a mind map that outlines the various methods a business may use to segment consumer markets. For each method, identify a potential group of customers that may be targeted.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 8.6 Unlike takeaway food customers, this market segment wants to cook a healthy meal with fresh ingredients, based on a tried and tested recipe.



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8.2 Product/service differentiation and positioning

Product differentiation

Product differentiation is the process whereby a business distinguishes the attributes and features of a product from those of its competitors' products. It is what the business believes will attract customers to its products over similar products offered by its competitors. Businesses may use a variety of strategies to emphasise product differentiation. These often focus on price and product quality.

Price

If a business intends to use **price** as the basis for product differentiation, it will promote itself as being the cheapest provider of a specific range of goods. Coles utilised this strategy to differentiate from its competitors. This was reflected in its previous slogan 'Down, down, prices are down'. Some businesses will use a business name that emphasises price differentiation. The Reject Shop and Supercheap Auto are two such examples.

Price The cost to the consumer of buying a good or service.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Business Bite

Jansport is an international manufacturer of bags and backpacks. It provides customers with a lifetime warranty on all its products in the event of damage. Jansport is one of only a few companies to offer this post-sales service, providing the business with a point of difference.

Source 8.7 Jansport offers customers a lifetime guarantee for all of its backpacks.

Product quality

Some businesses attempt to differentiate themselves based on product quality. They believe that the quality of their products is what will successfully distinguish them from their competitors. Businesses often use a slogan that promotes product quality. For instance, Tiffany & Co. uses 'Beautiful design makes a beautiful life', while Audi distinguishes its cars as 'Advancement through technology'.

Service differentiation

Service is crucial to the success of any business. It is an important feature of all businesses, as it involves a direct and immediate form of contact between the business and the consumer.

While small businesses may be limited in their product range and ability to provide discount prices, it is widely acknowledged that the service offered by small businesses is more personalised and effective than that offered by their larger competitors. Businesses may use a variety of strategies to emphasise service differentiation. These could include after-sales service. Some businesses recognise the importance of maintaining a relationship with their customers after the purchase. They believe that this will develop into strong brand loyalty.

8.3 Products

Goods and/or services

The term 'product' can refer to either a good or a service. While some businesses provide consumers with products that are tangible (that is, they can be seen and touched), other businesses will offer services to consumers, which are products that involve one person performing a task on behalf of another person. Oporto, for example, provides consumers with a food product, while tax agent H&R Block provides bookkeeping and accounting services. A product offers a consumer tangible and intangible benefits. Tangible benefits are the physical attributes of the product. These can include the design, style, colour and features of the product. They can be seen, touched or used.

Intangible benefits are the benefits a consumer associates with purchasing a product. These

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could include the prestige and image associated with owning a particular brand and the after-sales service a business offers its customers, such as customer care help desks, warranties and maintenance checks. When developing its marketing strategies, a business must look beyond the physical attributes and features of its product. It must also consider other product-related marketing concerns, such as positioning, branding and packaging.

Positioning

Positioning refers to the image that a product has in the mind of a consumer. It is based on the way consumers compare one product against alternative products. Positioning is determined by how consumers perceive the product in terms of the relationship between product quality and price. The position of some products is that of prestige and reliability.

Branding

Branding refers to the reputation that a business or product has developed over a period of time. The brand name or logo attached to a product essentially provides a message to consumers about the quality, value or prestige associated with that product. Over time, consumers come to develop expectations of certain products and brands. These expectations arise from the reputation that the products and brands have established over some time. When a consumer recognises a brand name, they are immediately able to form judgements on its product quality, price and value. A strong brand name is important in enhancing the relationship between a business and its customers. An organisation that is well respected for its product quality is likely to retain its customers over a business that has encountered negative publicity due to faults in its products.

Packaging

Packaging refers to the physical appearance of the good (that is, how a good appears when it is presented for sale). While packaging has little or no impact on how the product will be used by the consumer, it is often the first image of the product that the consumer will see, and therefore the image needs to be effective and positive. Packaging of a product is significant in influencing customer buying behaviour. Even minor improvements in the outward appearance of a product can have an impact on customers.

The packaging of a product also aims to protect and maintain its quality. In recent years, businesses have developed packaging to maintain and enhance the quality of the product once it has left the manufacturer. Foil wraps for food and seals for medical products are examples of improved packaging that benefit consumers.

Packaging is also important because it is the last point of contact between the producer and the consumer before the final purchase decision is made. The packaging must offer the consumer some reason to buy the product. It could reveal the benefits of using the product or the product's features, nutritional information or colour, design and style. In recent years, businesses have used packaging to convey their commitment to becoming more environmentally friendly.

Positioning The image that a product has in the mind of the consumer. How consumers compare one product against alternative products.

Branding The reputation that a business or product has developed over a period of time.

Source 8.8 Brand packaging is a key part of communicating with the consumer.

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The packaging of services differs considerably from the packaging of goods. The packaging of a service includes, for example, the attitudes and product knowledge of the salesperson and that person's willingness to assist with customers' concerns and enquiries. When considering the packaging of a service, consumers will look at the level of service provided by the business when they are buying it.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Activity 8.2
Discussion

Conduct a class debate on the following topic: Does the colour of packaging influence a consumer's buying behaviour?

8.4 Price

Price refers to the amount of money a business charges for the purchase of its products. It is often one of the most influential considerations for a consumer before purchasing a good. The price charged by the business must reflect the position and branding of the business or product within the marketplace. A brand that is well established and highly regarded in terms of reliability and value may sell for a higher price, with the expectation that consumers will pay for the perceived benefits of using the brand.

Pricing strategies

Penetration pricing A pricing strategy whereby prices are set at the lowest possible price to gain an immediate group of customers.

Loss leader A pricing strategy that involves providing a limited number of goods at a price that generates minimal profit or even a loss to encourage consumers to purchase goods from the business.

Product-deletion pricing A pricing strategy that is used to clear stock that a business believes is no longer selling or attracting interest from consumers.

Price skimming A pricing strategy that is used when a business wants to recover the high costs involved in establishing a product and releasing it onto the marketplace by setting a high price. It then lowers the price over time.

Pricing strategies may be divided into two categories: those designed to generate fast sales, and those designed to achieve the greatest financial return.

Strategies to generate fast sales include:

- *Penetration pricing*: A **penetration pricing** strategy refers to setting prices at the lowest possible figure to gain an immediate group of customers. It is used to penetrate a market and gain market share rapidly by setting a price much lower than competitors' prices. Penetration pricing aims to undercut the main competitors of the business and act as an incentive for consumers to switch over to the new product. Once a loyal group of customers has been developed, it is expected that the business will raise its prices. By this time, it is hoped that consumers are attracted to the product for its features and reliability more than its price.
- *Loss leaders:* The **loss leader** pricing tactic involves providing a limited number of goods at a price that generates minimal profit or even a loss to encourage consumers to purchase goods from the business. A business using this strategy will lose money on the loss leader goods it sells if the price is set below the cost of making and supplying the goods. The aim of this pricing structure is to entice consumers into a store with the availability of some stock that is relatively inexpensive. It is hoped that, once in the store, consumers will purchase other goods that will be slightly more expensive than those of competing businesses.
- *Product-deletion pricing:* The **product-deletion pricing** strategy is used to clear stock that the business believes is no longer selling or attracting interest from consumers. The purpose is to quickly clear the stock from the store and allow the business to replace it with goods that are currently popular and more likely to sell. For example, when a new car model is about to come out, car yards will often have run-out sales on the old model, to clear out the old stock and make way for the new.

Strategies to achieve the greatest financial return include:

- *Price skimming:* Some businesses are known in the marketplace for their innovative products and ability to constantly improve the features of their products. A business cannot achieve such innovation and improvements without devoting considerable funds to research and development. The **price skimming** pricing tactic is used by a business when it wants to recover the high costs involved in establishing a product and releasing it onto the marketplace by setting a high price. It then lowers the price over time.

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Business Bite

Source 8.9 Many customers pre-ordered the new Sony PlayStation 5.

Sony used a price skimming approach with the launch of its new PlayStation 5 console. The high prices charged, in part, appeal to the 'early adopters' segment, but also reflect the degree of innovation and development in the product creation.

- *Price points:* 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 and provide businesses with a larger pool of customers to sell to. Businesses such as Apple do this when offering different versions of the iPhone (e.g. 12, Pro and Pro Max).
- *Prestige pricing:* Consumers' perceptions of a product will influence the price they are willing to pay for it. This perception is influenced by product quality, reliability and the image associated with owning such a product. Prestige pricing is used for products that consumers regard as prestigious and, therefore, for which they are willing to pay a higher price. Fashion brands such as Gucci and Balenciaga use this strategy to reflect the prestige of owning their products.

Pricing methods

There are a number of different approaches to pricing methods:

- *Cost-plus pricing:* The **cost-plus pricing** tactic takes into account the total cost to the business of manufacturing or providing a good or service to the consumer and then adds an additional amount to allow for a profit margin.
- *Competition-based pricing:* Competition-based pricing is a commonly used pricing strategy. It involves a business publicly stating that it will match the advertised price of the product sold by a competitor if that price is lower than the price the business is charging for the same product.
- *Market-based pricing:* It is generally assumed that, within the business environment, the higher the demand for a product the stronger the ability of the organisation to charge a higher price for that product will be. An organisation that prices its products based on this assumption is using the market-based pricing tactic. This is used by airlines and hotels, which often charge higher pricing during periods of higher demand such as school holidays and Christmas.
- *Psychological pricing:* Research has shown that consumers are influenced by even the most minor price difference. Psychological pricing is the pricing tactic used to take advantage of this consumer response. For example, although there is only a $1 difference, consumers will react in a more positive way to a product priced at $99 than if the price was set at $100.

Cost-plus pricing A pricing strategy whereby the business considers the total cost to the business of manufacturing or providing a good or service to the consumer and then adds an amount to allow for a profit margin.

Price and quality interaction

Consumers often associate price with quality. Goods and services that are expensive are perceived by consumers to be of higher quality than cheaper equivalents. Lower prices are

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regarded as being reflective of the poor quality of the product. This perception is not necessarily accurate. Many consumers are willing to pay more for a good or service because of the perceived quality benefits. High-quality goods tend to last longer and break down less frequently than goods of lower quality. In regard to quality of services, consumers will seek the highest-quality expertise and skill they can afford. This could include more qualified solicitors and physiotherapists, for example.

Review 8.1

Analysis

Answer these questions on paper or in the Interactive Textbook.

For each of the situations described below, identify the pricing strategy used by the business.

1. Bergy Realty is a new real estate agency that has just opened up in an area where there is high competition. Its commission fees are the lowest in the area.
2. Jim sells customised furniture using premium leather imported from Italy.
3. Emilio's Cheap Servo sells petrol to customers below the cost price if they spend $15 or more in store.
4. Nicole's Designz is a fashion boutique that is overstocked with clothing from last season. All products are 50 per cent off.
5. Ted-Fix-It is a 24-hour IT repair service. The business charges a premium for emergency call-outs with short notice.

8.5 Promotion

Promotion is the most public aspect of marketing. It is that arm of the marketing mix that gives the business its public image and profile. Marketing is often the first form of information that a consumer will receive about a product. Promotion can take many forms. From the traditional methods of advertising through the media to more innovative methods (such as publicity stunts), promotion is a core element of any marketing plan.

Source 8.10 Trying beauty products at a sales party for cosmetics

Elements of the promotion mix

The promotion mix is that part of the marketing mix that seeks to generate interest in and awareness of a particular product or brand. The various elements of the promotion mix include:

- *Personal selling:* Personal selling aims to establish a direct link between the business and the consumer. It involves the process of taking the business and the product directly to the consumer. Forms of direct selling include door-to-door sales and party plans. While door-to-door sales have experienced a considerable slowdown in their popularity, party plans are a popular method of selling due to the range of products that can be sold. No longer are these parties restricted to people being shown displays of plastic kitchen products or make-up. Party plans selling jewellery, clothing, toys, plants and cosmetics are increasing in popularity. In recent times, businesses have become much savvier at using social media to engage with customers and promote their goods and services.

  Hairdressers and beauticians may be given complimentary cinema tickets in return for telling their customers how much they enjoyed a particular show. The client is not aware that the service provider has been engaged by another business to sell the product in return for complimentary goods.

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This word-of-mouth style of personal selling is referred to as whisper marketing.

Businesses now target advertisements to their customers via online advertising. Consumer behaviour on the internet is often tracked through cookies, allowing businesses to then advertise their products directly to the consumer.

- *Relationship marketing:* Many companies have recognised that clients represent more than a point of sale. They are, in fact, the lifeblood of the business and strongly influence its profitability and growth prospects. **Relationship marketing** is the process of building and maintaining long-term relationships with customers. It involves creating a high level of customer satisfaction, value and service, thus ensuring that customers will return to the business. It is based on the concept of promoting brand loyalty among consumers. Loyal customers provide a constant client base and are likely to refer the business to family and friends.

  Relationship marketing is used by many businesses. Through the establishment of a regular client base, businesses are able to offer special packages, discounts and promotional events. They use loyalty cards to reward frequent customers. Businesses making use of this include airlines (Qantas Frequent Flyer, Virgin Velocity), supermarkets (Woolworths Everyday Rewards, Coles Flybuys) and food outlets (Gloria Jean's eSipper, Oporto Flame Rewards).
- *Advertising:* For the majority of businesses, advertising is the most public face of the promotion mix. It is the most common form of promotion used by Australian businesses. It seeks to convey a message to a broad group of customers. Advertising traditionally appears in the media (such as television and magazines), although the increasing use of e-commerce has made the internet a powerful advertising medium.
- *Sales promotions:* Sales promotions are intended to create interest in and generate awareness of a particular product. These promotions include competitions, samples, discounts and offers to buy one and get one free. Businesses are increasingly using the internet as a form of sales promotion. Many businesses will ask customers for their email addresses. This provides the business with a cost-effective method of attracting the interest of consumers through a variety of forms. A common promotion would be emailing the consumer information regarding clearance sales, customer preview evenings and discounted dining offers. They often have a competition to win something if you sign up to their emails.
- *Publicity and public relations:* Public relations, or publicity, is the process of creating an event for a business to generate awareness of its products and, in so doing, attracting interest in the business's activities and its products (for example, a product launch at a new art studio/shop or a new exhibition at the museum).

Relationship marketing The process of building and maintaining long-term relationships with customers.

The purpose of these forms of promotion is to increase brand awareness. Often Australian businesses will pay overseas music and film stars considerable amounts of money to visit Australia and launch a new product. Media interest in the celebrity will always carry with it the reason why the celebrity is visiting Australia; hence, the business and its brand profile benefit considerably.

The communication process

Promotion is the element of the marketing mix that a business uses to convey a message. Therefore, communication is the most important aim of any promotional campaign. The promotional strategies of a business should be effective in communicating to the product's target group of customers. When developing a promotional campaign, a business should use market research. This will allow the business to develop strategies that will attract the interest of the product's intended market. Often customers are willing to purchase a product if the business's message is communicated via opinion leaders and through word of mouth.

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Ethical Spotlight 8.1

Suggestive promotions are used to attract the attention of consumers. They generate awareness and interest. Research what suggestive promotions are and find some examples. Should businesses be able to use suggestive methods of advertising to promote their products?

- *Opinion leaders:* Businesses recognise that certain individuals in the community are highly respected and they often seek to use these people to promote their products. Whether it is their profile within the community, their knowledge and expertise or even their personality, these opinion leaders are used to sell a product on the basis of their influence. Many businesses use social media 'influencers' to promote their products and gain access to thousands of potential customers. The benefit of using an opinion leader is that consumers will create a link between the leader's image and reputation and the product.
- *Word of mouth:* Word of mouth is a form of publicity over which many businesses have little or no direct influence. It involves consumers relating to others their reaction to the use of a product, including the degree to which they were satisfied with it. Positive word of mouth is a valuable form of promotion. Given that it is not coming from the business but from those with whom consumers associate on a daily basis (such as family and friends), consumers are likely to place more weight on word of mouth than on the biased images presented by the company. It may influence a consumer to either try the product or avoid it, depending on the information the consumer received.

Activity 8.3
Research

Scroll through your social media feed (or the internet), to find a celebrity who is endorsing a product. Use that information to answer the following questions.

1. Describe the product being advertised.
2. Define who you think the target market for this product is.
3. Explain why you think this individual has been used to promote this product.
4. Assess how successful you think this celebrity endorsement is in appealing to the intended market.

Digital quiz
Please see the Interactive Textbook to access digital activities.

8.6 Place/distribution

Place is the fourth element of the marketing mix. It is primarily concerned with the process of distributing the product from where it is made to the consumer.

Distribution channels and reasons for intermediaries

Place The methods of distribution and availability of a good from different outlets and locations.

Distribution channels The channels by which a product is moved from the place of manufacture (the product's place of origin) to the consumer (the product's final user).

Distribution channels are the channels by which a product is moved from the place of manufacture (the product's place of origin) to the consumer (the product's final user). The distribution process may involve a number of steps. There are three common channels of distribution that various businesses may use.

1. *Producer to consumer:* The good or service is produced by an individual/organisation and is then passed directly on to the consumer. There is no other business involved in the selling; that is, no intermediary is used. An intermediary is a business that purchases the final product and then takes on the responsibility of selling this product to the consumer. Examples of products with a producer-to-consumer channel of distribution are those provided by the services and hospitality industries, such as taxation accountants, hotels and dentists.

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2 *Producer to retailer to consumer:* A producer may need to include a retailer in the distribution channel. The retailer is used as an intermediary who accesses the good from the producer and then sells it to the consumer. This is a popular method of distribution, and the retailer and producer will often share marketing responsibilities. It does, however, restrict the ability of the producer to directly examine and influence the buying patterns and behaviour of consumers. Examples of this include supermarkets and department stores that sell branded products on behalf of the producer. Coca-Cola, Arnott's and Samsung all sell their products to retailers who then sell on to consumers.
3 *Producer to wholesaler to retailer to consumer:* The producer-to-wholesaler-to-retailer-to-consumer distribution channel includes an additional intermediary: the wholesaler. In this system, the wholesaler buys the product in bulk quantities and then distributes to various retailers.

Channel choice

The choice of distribution channel will influence the types of customers the product attracts, the perception of the product in the market and, above all, the ease with which the consumer is able to access the product. The distribution channels can be categorised as intensive, selective and exclusive.

- **Intensive distribution** occurs when the product is readily available to a wide selection of stores or locations. The product is easily accessible by consumers, can be found at a number of different types of stores and is often included in everyday purchases. Convenience items (such as milk, soft drink, confectionery and newspapers) are examples of products that lend themselves to intensive distribution.
- **Selective distribution** involves the use of a limited number of stores/locations to sell or distribute a product. This method allows a business to control where its product is sold, and to ensure that the places chosen are consistent with the image that the business is attempting to project and that the product will reach its target market. Industrie is a men's fashion brand available at a limited number of Industrie stores as well as Myer and David Jones stores. The stores where this fashion brand is sold all appeal to the same demographic.
- **Exclusive distribution** is a form of distribution in which there is a restriction on the number of products and/or availability of the product. The product is available at a very limited number of venues. This allows the business to maintain control of all elements of the production, distribution, sales and marketing of the product. Maserati is a world-renowned luxury car manufacturer. The vehicles it produces are only available in eight dealerships nationwide. Each dealership has been strategically chosen to be in close proximity to customers with high income and socioeconomic status.

Intensive distribution Occurs when a product is readily available to a wide selection of businesses or locations.

Selective distribution Involves the use of only a limited number of stores/locations to sell or distribute a product.

Exclusive distribution A form of distribution where there is a restriction on the number of products and/or availability of the product. The product is available at a very limited number of outlets.

Source 8.11 Advantages of the commonly used distribution channels

Producer to consumer	Producer to retailer to consumer	Producer to wholesaler to retailer to consumer
Allows the producer to maintain control over all areas of the product, including quality control and marketing.	Allows the producer to concentrate on the manufacturing component of the business's operations.	The use of a wholesaler allows the producer to hold smaller amounts of idle stock.
Provides the producer with a direct point of contact with consumers, allowing a better understanding of consumers' needs.	The use of a retailer encourages greater distribution and access to the good.	Marketing and sales tend to be the responsibility of the retailer, not the producer, thereby saving on costs.

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Source 8.12 Maserati dealerships are located in high-income suburbs.

Physical distribution issues

When a business is establishing the way it will physically distribute its product, it needs to consider several issues, including transport, warehousing and inventory.

- *Transport*: Transport is the process of moving goods from one location to another. Businesses must consider the length of time needed to transport goods from the place of production to the retail store, for example. The type of good being distributed will be an important consideration for the business in deciding on the best method of transportation. Many fresh foods must be refrigerated while being transported, and there is a limit on how long they may be stored. Transportation can be expensive and it is important that the business factors this cost into the final price of the good.
- *Warehousing*: Warehousing is the process of storing products before they are distributed to the consumer. Many businesses use warehouses as a facility to store the finished products. Warehousing allows a business to build up its holding stock of a particular good. The warehouse will distribute the stock to the retailer at a later time and with minimal delay. As with transportation, warehousing is influenced by the type of good being stored and distributed. Some goods can only be warehoused for a very limited time before losing their usefulness to the consumer. Examples of these goods, which are known as perishables, are fresh fruit, vegetables and flowers.
- *Inventory*: For any business, it is the sale of stock that provides the business with the means to achieve its financial objectives. Stock is also referred to as inventory. A business must ensure that it has sufficient stock to satisfy consumer demand. It is also important for the business not to overstock throughout other times of the year. Overstocking may force the business to hold clearance sales in which profits are reduced and may restrict the ability of the business to store new, possibly more attractive, forms of stock.

Review 8.2

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Discuss the advantages for a business of using selective distribution over intensive distribution.
2. A business has decided to source its products from a production facility in China. Explain some of the physical distribution issues that it must now consider.

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8.7 People, process and physical evidence

As mentioned at the beginning of the chapter, business analysts have recognised that the traditional concept of the 4Ps has become outdated. It is now suggested that the marketing mix involves seven key aspects. The three additional Ps are people, process and physical evidence (packaging).

Businesses need to consider the role that each of these new Ps plays in the marketing mix and the manner in which it can most effectively target a business's customer base.

People

An important aspect of any organisation is having the right people to support the company's products and/or service. This can be reflected through high standards of customer service across all aspects of the business. Excellent customer service is an important element of a business seeking to maintain high levels of customer satisfaction and repeat sales. This may include detailed product knowledge, engaging skills in communicating with the customer and attending to customer concerns in an understanding manner.

Process

The relationship that a business has with its customer does not end once the consumer has purchased a product from that business. Process is the consumer's total experience of buying the product, from a simple stage of searching for information to the final stage of experiencing the benefits of the purchase. All aspects of the sale process are focused on delivering to the expectations of the consumer. In recent years, many businesses have altered their operations processes to provide consumers with greater convenience. The use of ordering apps makes it less time-consuming for customers to buy goods.

Physical evidence

This refers to the physical appearance of the product across every aspect of its presentation to the consumer. An obvious element of this is packaging (discussed earlier, under 'Product'). The business should consider the size, shape, colour, material and label of the packaging of the product. The packaging needs to be able to talk to the consumer, as it is the final point of promotion where a business is able to communicate its value proposition to the interested consumer.

However, even when dealing with a service, or an intangible product, there may be a physical element that customers can see and feel (for example, a membership card).

Physical evidence may also refer to the people within a business and the visual presentation that they display to clients. It may relate to how employees dress and act. It can refer to how an office is set up, the professionalism of staff and advertising material. In essence, physical evidence relates to every single visual element of a business.

Each aspect of physical evidence is then crucial in promoting a positive image of the business to its client's base. In recent years, a number of NRL teams have lost significant amounts of sponsorship, as businesses no longer sought to have their image associated with the negative publicity that the clubs were attracting.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 8.13 Creating efficient processes is an important element for businesses seeking to appeal to time-poor consumers.

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8.8 E-marketing

The growth of technology over the past 20 years has considerably affected business operations. A key aspect of this is the manner in which businesses are able to interact with their customers. Technological media such as the internet has provided businesses with an opportunity to interact with customers in a manner not seen before. It serves as an area of personalised marketing, sales growth and brand awareness.

Internet marketing is also known as e-marketing. This is a broad form of marketing, as it also involves the use of emails to directly liaise and communicate with customers. E-marketing allows a business with online operations to reach a global audience. Internet marketing involves the use of a multifaceted approach to marketing. The website must be creative to attract the interest of consumers while fulfilling technical aspects of the site, ensuring that the site is user-friendly and suitable for the intended audience to navigate.

Digital marketing is now the fastest-growing sales platform in Australia. The 2020 Yellow Social Media Report claims that 90 per cent of large businesses in Australia have a formal social media strategy. Furthermore, 37 per cent of small to medium enterprises (SMEs) have paid for advertising on a social media platform. Using digital media to interact with customers is beneficial as it caters to a diverse group of customers, including time-poor consumers (usually owing to changes to work hours, shift work and seven-day and extended trading days) who are unable to access the traditional trading hours of retail stores or who wish to avoid queues and parking problems.

Stores have also sought to establish secure payment methods as a means of reassuring customers that their financial details are safe and secure.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 8.14 E-marketing is a key part of a business's promotion strategy. Social media advertising is an effective method of communicating with customers.

Q: Have you paid to advertise on a social media channel? If yes: What channel did you pay to advertise on?

Paid to advertise on social media	Total Sample (1020)	Business size		Location	
		Small (658)	Medium (362)	Metro (609)	R/R (411)
Yes	37%	34%	44%	41%	31%
No	63%	66%	56%	59%	69%
Channel	**Total Sample (380)**	**Small (221)**	**Medium (159)**	**Metro (251)**	**R/R (129)**
Facebook	83%	87%	78%	80%	90%
Instagram	22%	16%	30%	24%	19%
LinkedIn	16%	11%	22%	21%	6%
Twitter	12%	8%	18%	15%	7%
Snapchat	4%	3%	5%	4%	4%
Other	6%	6%	6%	4%	9%

8.9 Global marketing

Many businesses operate in countries beyond their domestic operations. This provides a business with an opportunity to increase sales, further its brand awareness and establish markets in new countries. Like people, not all countries are the same. Customers' needs and wants are influenced by such things as culture, income and standard of living. Because of this, some businesses will modify their product or promotional strategy to cater to the needs of their new foreign market.

Global branding

When a product can be marketed to consumers in many different countries, branding becomes very important. Because a brand has the same meaning in any language, a recognisable name and logo are essential. It is more effective and efficient to promote a brand rather than individual products. Coca-Cola has been very successful in using this promotional strategy. Brands become universally recognisable. The same marketing message is delivered to customers in different nations when they identify the brand.

Standardisation and differentiation

A business may not need to alter its core product to suit the same target market in different countries (for example, Coca-Cola, whose taste is generally the same worldwide). Instead, it is able to supply a standardised product.

However, often a product will have to be differentiated in some aspect to suit different cultures and local markets. Owing to differences in language, religion, tastes and ethics, it is very important that a business planning to sell in a new market adequately researches the market to reduce the chances of the product failing. For example, as mentioned previously in this chapter, McDonald's has slightly different

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menus in different countries to reflect cultural preferences and religious values. The 7Ps of the marketing mix (product, price, promotion, place/distribution, people, process and physical evidence/packaging) must be appropriate to the new market.

Review 8.3

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Compare the standardised and customised approaches to global marketing. Use an example to explain the differences.
2. Discuss why a business may conduct a situational analysis (a snapshot of what the business is and where it stands in the market), when entering a global market.
3. Outline why a business may be reluctant to adopt a customised approach to its marketing.
4. Discuss the benefits of implementing global branding.

Global pricing and other marketing strategies

Global marketing strategies can be standardised. This is where the same strategy is used across the many countries in which a business operates, thus creating greater awareness of the brand. Alternatively, the business may customise its products to better suit the needs of its local market.

Often the marketing plan will aim to position the overseas product as having more benefits and being of better quality than locally made products. A global business may choose a 'hit and run' strategy by marketing a product aggressively, and maximising sales, before a competitor can copy the product or service.

Product

A product's features will vary from market to market to suit customers in different countries. Labels need to be printed in the correct language and may require additional information, according to legal and cultural concerns and issues. Where customers in developing countries have difficulty reading, the packaging will use pictures and diagrams; although these, too, can create misunderstanding. For example, a brand of tinned baby food in Africa was sold with a picture of a smiling baby on the label. However, as many product labels in Africa use a picture of what the product is made from, confusion was created because some customers believed the product was made out of smiling babies.

Business Bite

Source 8.15 Customised packaging has been a key to Jacob's Creek's entry into the Chinese wine market.

Jacob's Creek is a leading Australian wine producer. Over the past 10 years, the business has repositioned the brand for its entry into the Chinese market. The rise of the large middle class in China has presented the business with many growth opportunities. To take advantage of the lucrative Chinese market, Jacob's Creek amended its packaging and labelling to create a premium product that was demanded by the target market. As gifting is a strong part of the Chinese business culture, Jacob's Creek used premium cartons and boxes to demonstrate the quality of its wine. In 2019, the business experienced double-digit sales growth in China.

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Price

The pricing strategy used by a global business should add to the reputation of the brand. Because of the additional costs of exporting – packing, transport, insurance, documentation and currency variation – a competitive price is more difficult to establish. If customers perceive the product as value for money or exclusive, then the business will not have to compete with lower prices. A value-based pricing strategy can be used. Alternatively, a penetration pricing strategy, which involves charging a very low price that just covers costs, can be used to gain and establish market share. Or the product can even be a loss leader, where the global business loses money on each sale, but the losses can be subsidised from profits made in other markets in other countries.

Competitive positioning Involves the formal process of a business determining how to differentiate itself from its competitors and, in doing so, develop strategies for the business to create value from those differences.

Promotion

Promotion involves much more than advertising on television. Global businesses have a variety of media they can use to promote their product, but they must understand the marketing variations needed in language, religion and culture. Language is a common problem, as product names do not always translate well and give the same meaning. Names and slogans can be meaningless, embarrassing or, at worst, offensive. A global business may need to outsource promotion to a local advertising agency because it will best know its own market.

Place

Place in the marketing mix refers to the process of delivering the product to consumers so that it is available to them to buy. The internet has had an obvious impact here by creating 24-hour shopping with the convenience of not having to leave the home or office.

Having a good relationship with the local distributor is important. It will ensure products are given the attention they need to succeed. The distributor's staff need to be given training to correctly promote the good and provide after-sales service. Personal visits to the distributor by a senior manager are most important to establish and maintain this relationship.

Competitive positioning

Competitive positioning is a cornerstone of any successful business. It involves the formal process of a business determining how to differentiate itself from its competitors and, in doing so, develop strategies for the business to create value from those differences.

When customers are able to clearly see the manner in which a business differentiates itself and how it is different from its competitors, it becomes much easier for the business to highlight key points of difference. Without differentiation, a business would require more time and money to develop customer and brand awareness. One of the key elements of competitive positioning refers to the concept known as value proposition. There are three essential types of value: operational excellence, product leadership and customer intimacy.

Business Bite

Hismile is a teeth-whitening business established by two Australian entrepreneurs. The owners of the business recognised a gap in the oral hygiene market and developed a range of products that could be used by customers at home. The business has gained global recognition by adopting a range of promotional strategies. These include the use of social media advertising and celebrity endorsement. Sales in the business have grown significantly after Kylie Jenner publicly endorsed the teeth-whitening kits on her Instagram account. Hismile has continued to use opinion leaders to appeal to the primary market of millennial women aged 15 to 24.

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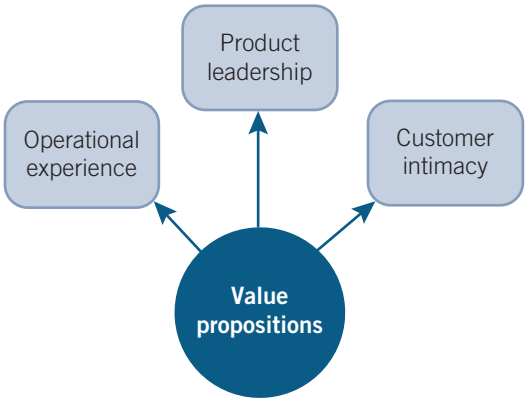
Operational excellence refers to the ability of the business to be run efficiently as a means of producing a low-cost operation. The benefit of this structure allows the business to pass on cost savings to consumers. A business with lower costs is able to offer consumers lower prices. This form of excellence and efficiency is achieved across all aspects of the business. The business promotes this efficiency and customers are reminded that operational excellence does, in fact, result in lower prices.

Product leadership refers to a business that continually enhances its brands through innovation and quality. The business is constantly working on product improvements and new ideas that it can bring to market. This allows the business to capture a greater share of the market. It is seen as a leader within the marketplace and is often associated with high brand awareness and strong consumer loyalty. A good example of this is the Apple iPhone.

Customer intimacy involves a business developing a personalised profile of its customers' shopping habits so that the business is able to deliver the correct marketing strategies over time. The business develops a relationship with the customer in order to develop a long-term association. This is achieved through a detailed understanding of the buying behaviour of customers. Technology is a key component of developing customer intimacy. For example, Woolworths emails Everyday Rewards cardholders a notice of specials that may interest them, based on their shopping records.



Source 8.16 Competitive positioning: value propositions

Business Bite

The Iconic is a leading online fashion retailer in Australia and New Zealand. The business has continually evolved its marketing strategies to develop a competitive advantage against more established retailers. Part of the The Iconic's success has been due to the same-day express delivery it provides customers with. The business offers a wide range of fashion labels at different price points and invested in improving the customer shopping experience. The 'Snap to Shop' feature allows customers to upload a photo of their desired item of clothing onto the company website. An algorithm then compares it against the existing product range and produces a populated feed of similar products across various brands. This has been highly successful for customers of The Iconic who are time-poor and value the added convenience.

Activity 8.4
Research

Research some of the great international marketing errors that have occurred. What examples can you find of unfortunate translations of product names and slogans?

They may be quite different from the strategies used in the domestic market. It is even possible that the name of the product once translated is meaningless or even offensive in the foreign market.

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Chapter summary

Market segmentation is the process of breaking down a total market into smaller markets based on the similar characteristics of a customer group.

Geographic segmentation is the process of developing marketing strategies based on the different geographic locations of customers.

Demographic segmentation refers to the selection of target groups based on characteristics such as age, gender, income, family size and level of education.

Psychographic segmentation allows a business to segment markets based on people's lifestyles, personalities, values and interests.

Behavioural segmentation examines how often and when a consumer will make use of a product, the benefits sought when purchasing the product and user loyalty.

The traditional 4Ps are product, price, promotion and place/distribution.

A product is the good or service that a business is selling. Positioning is the image that the product has in the mind of a consumer. Branding refers to the reputation that a business or product has developed over a period of time. Packaging is the physical appearance of the product.

Price is the amount of money a business charges for the purchase of its products.

The pricing strategy used by a business will depend on its marketing goals. There are various strategies, including penetration pricing, loss leaders, product-deletion pricing and price skimming.

Promotion is that element of the marketing mix that raises awareness and interest in a particular product. Common elements of promotion include advertising, direct marketing, personal selling, and public relations and publicity campaigns.

Place is primarily concerned with the process of distributing the product. It must consider how the good is transported from the place of manufacture to the consumer and from where the good or service will be accessible.

The product distribution channels can be categorised as intensive, selective and exclusive distribution.

When physically distributing a product, a business must consider issues relating to transport and warehousing and the appropriate level of inventory.

The 7Ps of marketing include the traditional 4Ps with business analysts now incorporating people, process and physical evidence into the marketing mix:

- 'people' refers to the conduct and performance of employees
- 'process' involves the complete buying experience a customer has
- 'physical evidence' refers to all the visual elements of a business.

E-marketing is the use of the internet to promote and sell goods and services.

Global branding occurs when a business adopts a universal slogan and logo.

Product differentiation occurs when a product is modified to suit the needs of a local market.

Competitive positioning involves the formal process of a business determining how to differentiate itself from its competitors.

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End-of-chapter tasks

Chapter revision task

Create a table using the points in the three lists below. Your table should have three columns with the following headings: Keyword, Definition and Example. Match each keyword with the correct definition and example.

Keywords

- Market segmentation
- Demographic
- Marketing mix
- Branding
- Penetration pricing
- Price skimming
- Above the line
- Word of mouth
- Place
- Intensive distribution

Definitions

- Traditional forms of promotion used by businesses
- Setting prices at a high level to recover costs involved in research and development
- The area where a product is sold
- The process of choosing a target market
- The reputation a business or product has established over time
- Wide availability of the product
- Prices set at a level below competitors' prices in order to generate fast sales and establish market share
- The process of developing a product and then implementing a series of appropriate pricing, promotional and distribution strategies
- A form of publicity based on an individual's own experiences with the product
- Customer groups based on age, gender, income, family size and level of education

Examples

- A company advertises in newspapers, television and colour brochures.
- Sebastian posts on Facebook about the great meal he had at his local Italian restaurant.
- Gina's Gummybears are available in convenience stores, supermarkets and variety stores.
- Country Style is considering which department store is the appropriate retail outlet to sell its products through.
- Tasco's has entered the Australian grocery market, offering prices much lower than those of its competitors.
- Petros has released a new smartwatch onto the market.
- Rohan Clothing is widely respected in the men's fashion industry for its contemporary designs and quality garments.
- Given its location, Burger World is seeking to meet with local religious leaders to discuss the dietary requirements of its local customer base.
- Telchoice has released a new mobile phone package that offers consumers unlimited calls for $50 per month; it has advertised this on radio and the package is available from all Telchoice stores.
- Radio station WildFM plays dance music aimed at young adults.

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Multiple-choice questions

1 Salt Bae Steakhouse is planning on opening a new restaurant in Sydney. The marketing team conducts extensive research to identify certain areas where the population has a high socioeconomic background.

Which market segmentation approach is being used by the business?

A Demographic
B Behavioural
C Psychological
D Geographic

2 Which statement best describes behavioural segmentation?

A Market segmentation is based on the use of particular products by a certain group of customers.
B Market segmentation is based on the earning capacity of individuals.
C Market segmentation is based on a target group's age, gender and economic status.
D Market segmentation is based on an individual's lifestyle and personality.

3 Mobile phone companies are well known for their ability to offer consumers a basic product at several different price levels. At each level, the features that the consumer will receive differ. What form of pricing strategy would such a business be using?

A Penetration pricing
B Price points
C Price skimming
D Competitive pricing

4 In a bid to increase sales, the management of Pires Seafood decides that it will sell its oysters at a price below cost. What pricing strategy is this an example of?

A Price penetration
B Cost-plus margin
C Loss leader
D Price points

5 Dream Drives is an international producer of luxury sports cars and is looking to expand into the Australian market.

The least suitable channel for Dream Drives to adopt would be:

A extensive distribution.
B exclusive distribution.
C intensive distribution.
D selective distribution.

6 A business's reputation, logo and slogan, and consumers' expectations of its product are features of which element of the marketing mix?

A Positioning
B Branding
C Packaging
D Price and quality

7 Dom & Galluch is a private investigation firm that has several offices across the east coast of Australia. Management expects that all staff:

- maintain a clean office that is inviting for clients
- always wear the company uniform
- be courteous and professional towards all clients.

Which marketing strategy is being demonstrated in the case above?

A Promotion
B Physical evidence
C Process
D Positioning

8 Why does the marketing mix need to be differentiated when selling goods in different countries?

A It ensures that promotion does not offend customers in the domestic market.
B People in different countries like different things.
C It can make marketing appropriate for the foreign market in which it is sold.
D It advertises the product.

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9 A business sells a variety of laptops priced at $900, $1500 and $2500. What pricing strategy has it used?

A Penetration
B Prestige pricing
C Bundle pricing
D Price points

10 A global doughnut chain, Kippy Kremes, amends the ingredients of its doughnuts according to the tastes of each local market.

What strategy is the business implementing?

A Global positioning
B Global branding
C Customisation
D Competitive positioning

Short-answer questions

1 Describe how a business can differentiate its service.

2 Explain how businesses can use e-marketing to increase sales and market share.

3 Examine the importance of people, process and physical evidence to the marketing mix.

4 Assess why a global business would utilise a standard world price.

Extended-response question

Evaluate the success of marketing strategies in achieving marketing objectives. In your answer, refer to real business examples.

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TOPIC 3
Finance

25% of indicative time

Principal focus

This topic focuses on the manner in which business planning and management rely on the interpretation of financial data.

Introduction

Video 9.1 Introducing Topic 3 Finance

Effective financial planning is a key factor in the success of a business. It ensures that the business has the financial resources to achieve its goals and objectives. Financial managers consider the relevant internal and external sources and types of finance available and the funds needed by the interdependent functions of the business. Through strategic, tactical and operational planning, an organisation is able to determine its financial needs, implement control tools and avoid situations where it may have insufficient finances to fund short-term and long-term projects. Organisations can devise strategies to manage cash flow, working capital and profitability as well as their level of financial dealings in the global marketplace.

Comparative ratio analysis provides an important analytical tool for the financial manager. Using the relevant accounting information in this analysis enables the financial manager to determine the extent to which the business is reaching its financial goals and objectives. The financial reports developed and used by a business must present an honest overview of the organisation's financial performance. Stakeholders require clear and accurate information in order to make the best possible decisions regarding their involvement with the business.

Outcomes

Students will:

- evaluate how internal and external changes can influence management strategies
- discuss management's responsibilities regarding social and ethical matters
- analyse how large and global organisations use processes and functions
- explain the impact that management strategies have on businesses
- evaluate how a business's performance is impacted by effective management
- investigate current issues affecting businesses
- organise and evaluate information about real and potential situations affecting businesses
- communicate, using effective formats, details of business information, issues and concepts
- apply appropriate mathematical concepts to a study of business situations.

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Content

Students will learn about the role, influences, processes and strategies of business finance, through examination of current business issues, and investigation of real and potential business situations.

By the end of this topic

Students will have learned to:

- explain how short-term and long-term financial objectives may conflict with each other
- analyse how financial management is influenced by government and the international market
- identify what limitations exist when delivering financial reports
- compare the different risks involved in financial transactions conducted domestically and between different countries
- calculate figures using financial ratios
- use comparative ratio analysis to assess the performance of a business
- recommend strategies that will result in an improvement in financial performance
- examine the ethics of financial reporting practices.

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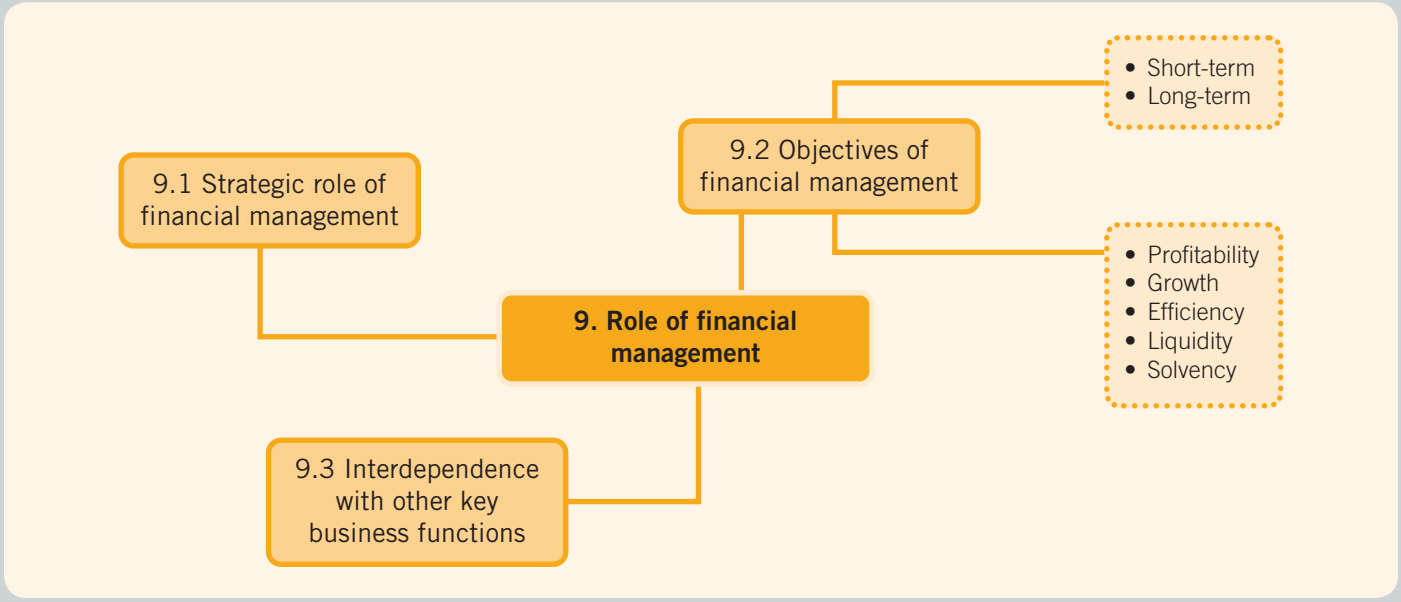
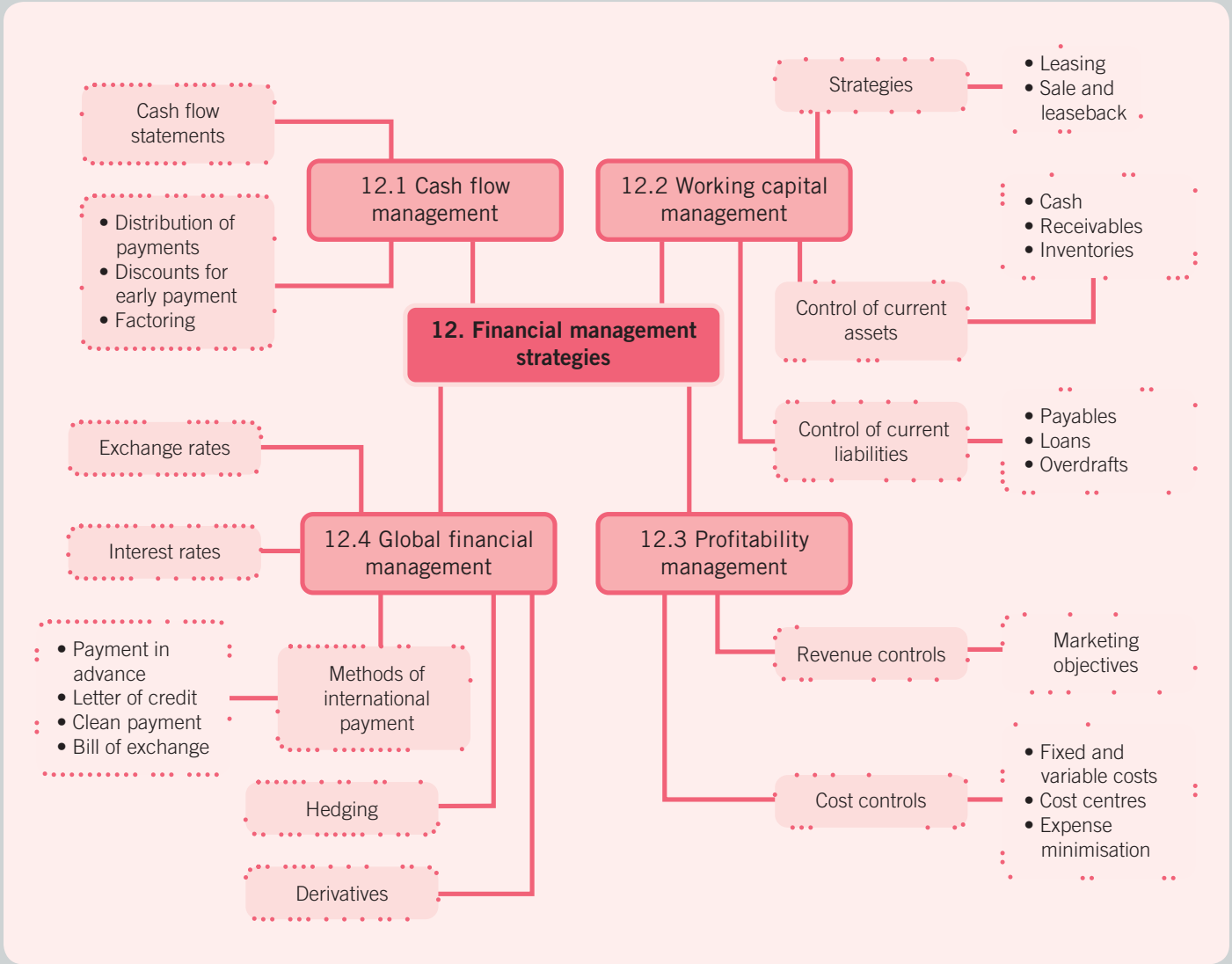
Finance





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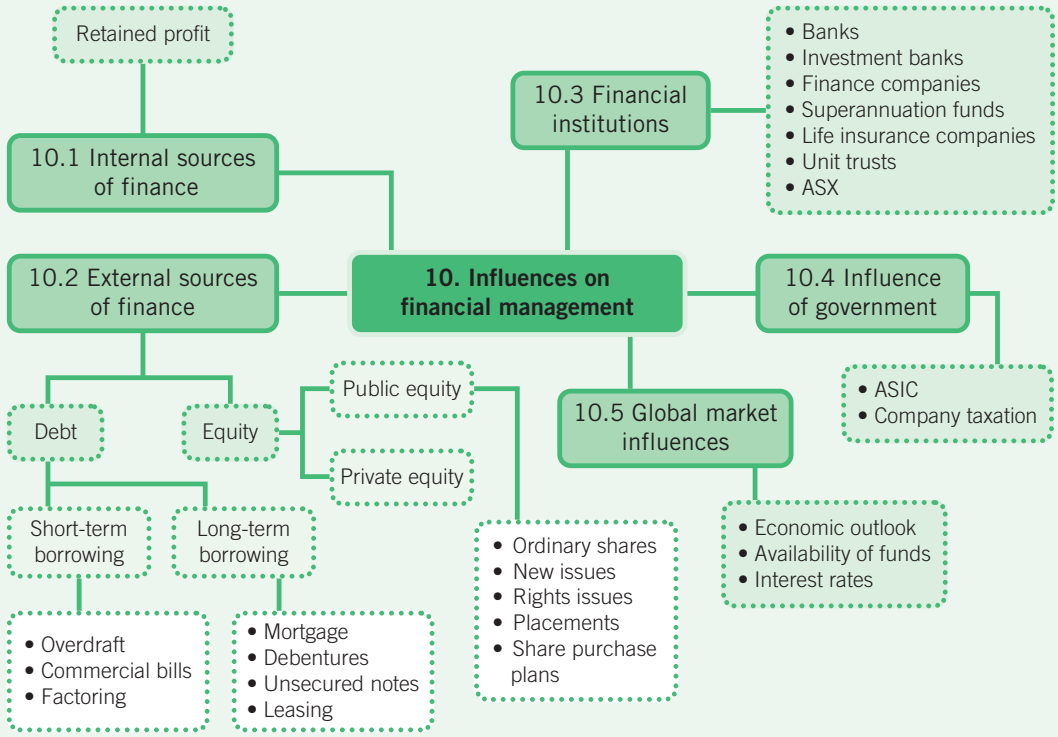

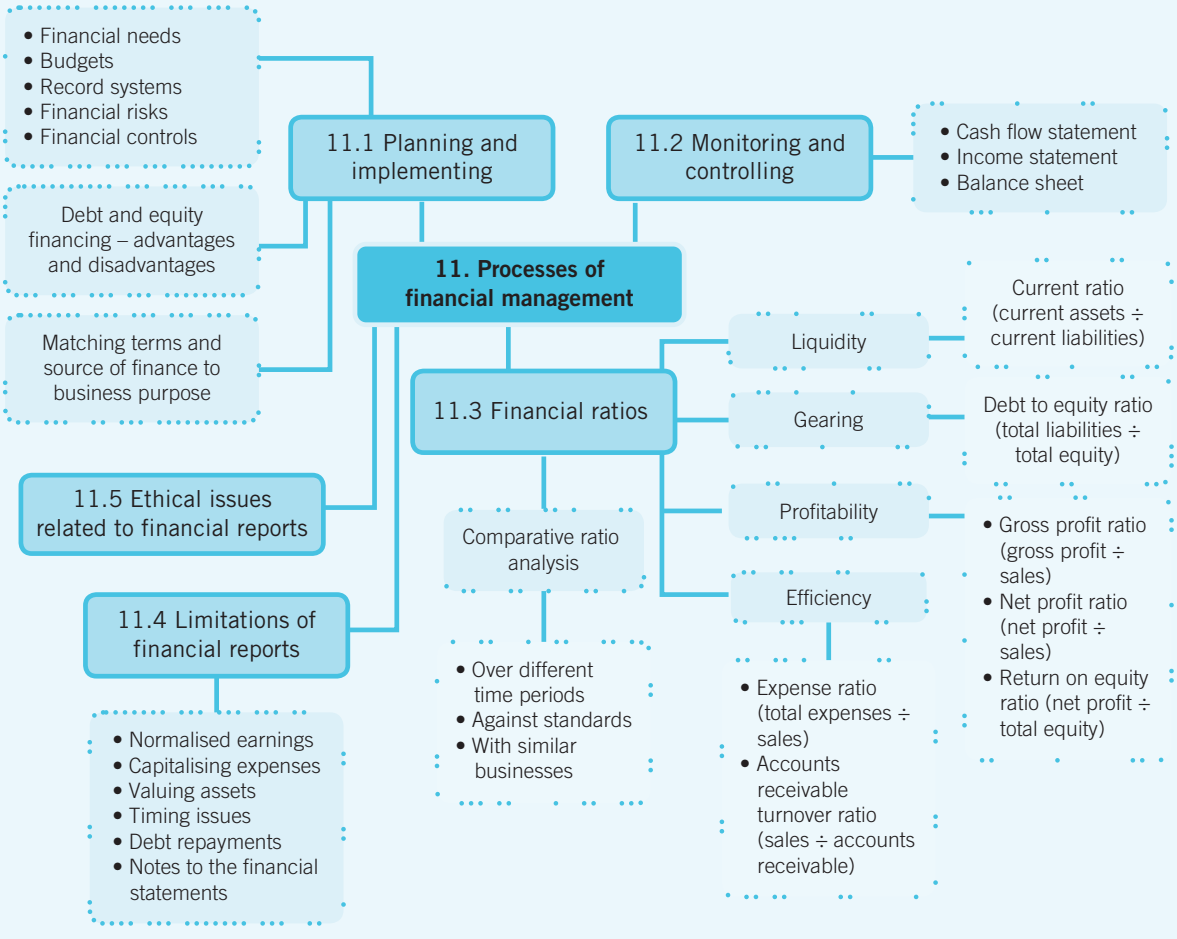

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9 Role of financial management

Chapter objectives

In this chapter, students will:

- investigate the strategic role of financial management
- analyse the objectives of financial management
- evaluate the interdependence of financial management with other key business functions.

Key terms

- accounts payable
- accounts receivable
- bankruptcy
- creditors
- current assets
- current liabilities
- debtors
- dividend
- drawings
- gearing
- goal
- gross profit
- growth
- invoice
- liability
- liquidity
- long term
- net profit
- objectives
- profit
- profitability
- short term
- sole trader
- solvency

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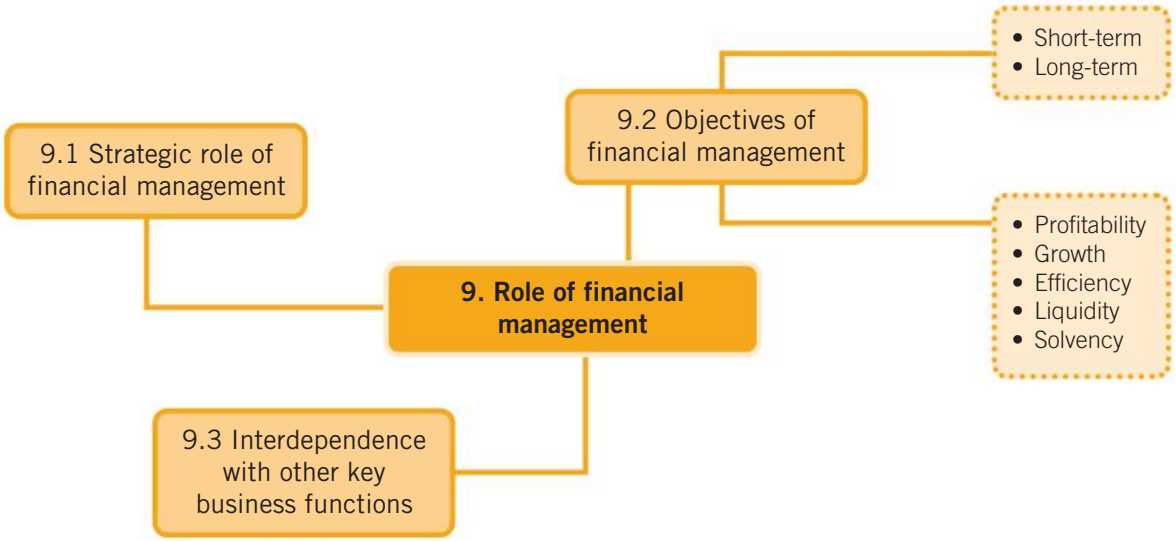
9.0 Introduction



Source 9.1 Role of financial management concept map

Digital quiz
Please see the Interactive Textbook to access digital activities.

Financial management deals with the analysis, interpretation and evaluation of all financial records of the business. It is a financial manager's responsibility to source finance that will enable the business to achieve its strategic goals.

9.1 Strategic role of financial management

The term 'strategic' refers to a long-term plan. A business's strategic plan is the long-term plan for the business as a whole and outlines its future direction. It will possibly cover 5–10 years and be constantly updated to deal with changes in the dynamic external environment in which the business operates. The strategic role of financial management within this plan is to effectively and efficiently ensure that a business sources and controls its funds so that it continues to operate, grows and is able to achieve its future financial **goals** and **objectives**.

One of the toughest periods for a business to survive is its first year of operations: the establishment phase. During this phase of the business life cycle, the short-term financial objective for most businesses is to ensure that they are able to cover their costs by paying bills as they fall due and ultimately to make a profit. In Australia, for the financial year ending June 2019, there were 20319 appointments to liquidators for business closure through the Australian Securities and Investments Commission (ASIC). Of these, 53 per cent were voluntary liquidations through decisions made by creditors and 31 per cent were court-appointed. These **bankruptcy** issues are heard by the Federal Court of Australia. The majority of these, 76 per cent, were small to medium private companies that had less than 20 full-time employees.

Goal A measurable and observable long-term aim. It identifies the business's direction and focus for the future. Goals may involve several objectives.

Objectives A series of short-term steps or targets needed to achieve the final goal.

Bankruptcy A legal declaration that a person or business has more liabilities than assets. A consumer or business that is unable to pay its bills may be formally declared bankrupt by a court. A business may declare itself bankrupt voluntarily as part of the process of closing the business.

Source 9.2 illustrates the decision-making process used by owners and managers for all goals and objectives, including those concerning financial management.

Financial managers need strong accounting knowledge and skills to interpret and analyse a business's financial data. Accounting is the language of the financial aspects of the business. It is used to measure, process and communicate financial information.

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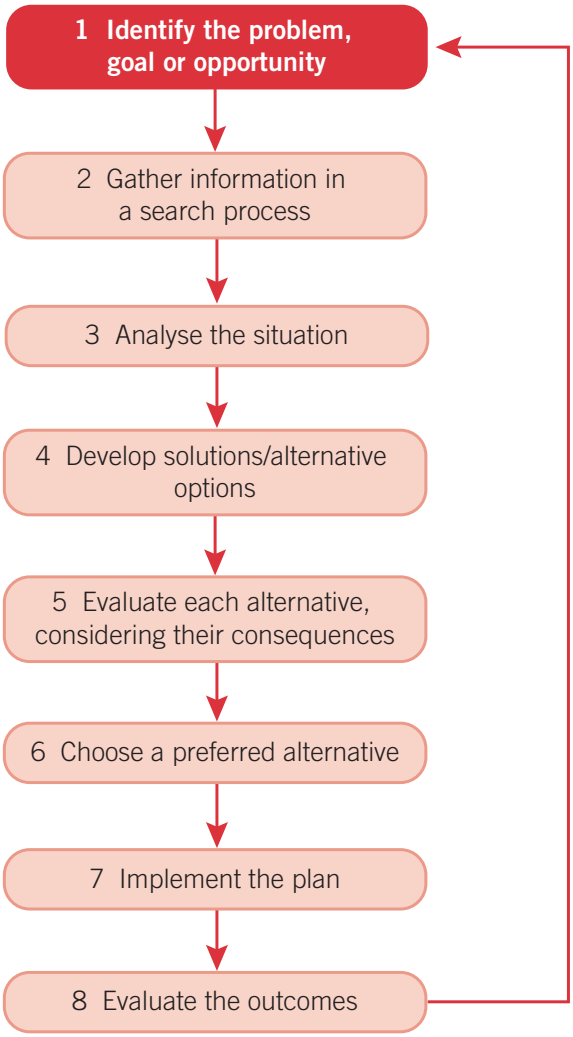

Source 9.2 The decision-making process used by owners and managers

Digital quiz
Please see the Interactive Textbook to access digital activities.

9.2 Objectives of financial management

Businesses must decide what they want to achieve – what their strategic goals are. This is how they measure their success. There are different ways to measure the financial success of a business. The first measure owners want to establish is how much **profit** their business is making – that is, how much revenue remains after all expenses have been paid – which represents their return on the **capital** they have invested in it. Any profit belongs to the owners. They can use this money for whatever purpose they wish.

Profit What remains from revenue after all expenses have been paid.

Drawings Money taken out of a business by a sole trader or partner for their personal use.

Sole trader An unincorporated business with one owner.

Dividend The income earned from owning shares in a company. It is usually paid every six months and is based on the profits the company makes.

Capital The money used for investment or starting a business

The owners can choose to reinvest money back into the business to help it grow and expand (this is known as retained profit, as the owner is choosing to retain part of the profit in the business) or withdraw money for their own use (this is called **drawings** in the balance sheet for a **sole trader** or partnership, and **dividends** for a company).

The role of financial management is to develop a tactical plan identifying short-term financial objectives and strategies that enable finance to support the whole business in achieving its strategic goals (see Sources 9.3 and 9.4). The financial manager's objectives will include the business's profitability, growth, efficiency, liquidity and solvency (see Sources 9.4 and 9.5). Their job will be to make short-term and long-term funding decisions on debt and equity sources of funds, to develop financial policies such as cash control or borrowing, and make the best use of the organisation's scarce financial resources.

Ethical Spotlight 9.1

Imagine you are the financial manager of a medical research facility. Do you direct your financial resources towards medication for illnesses that currently have large grants available from the government or do you use your funds for an illness that only affects small numbers of people in your own country and large numbers of people in developing countries?

Financial reports give a detailed financial picture of the business's profitability and financial stability. The financial manager will be able to measure the extent to which the financial objectives and financial goals of the business have been achieved. Analysis of the data will show change in the results from one year to the next, providing a trend for the business. The financial manager can use these changes and trends to determine whether the business is making more profit and is more financially stable than in the previous year.

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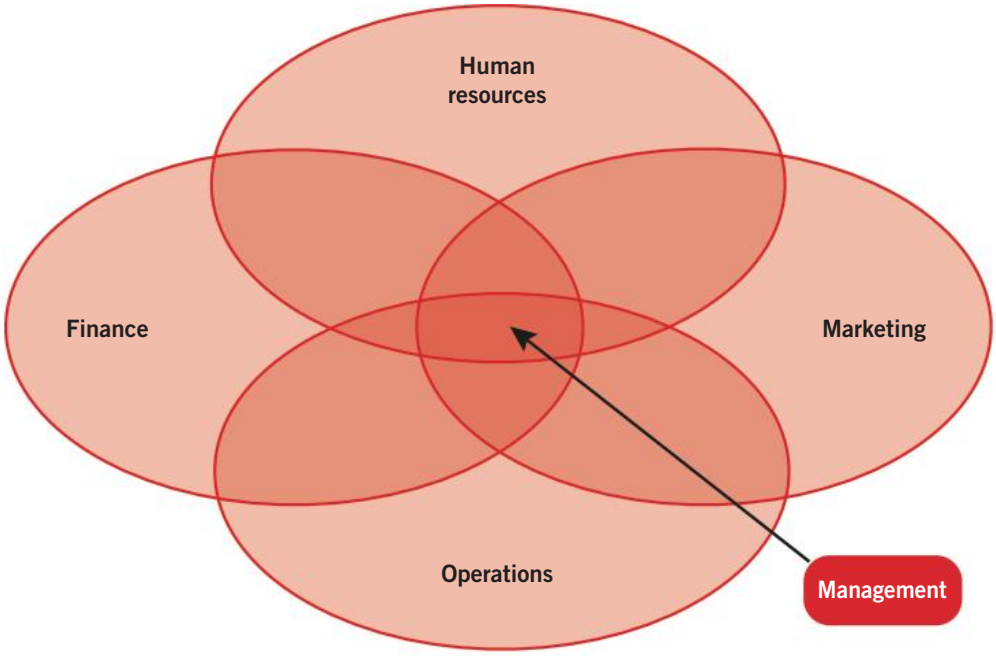
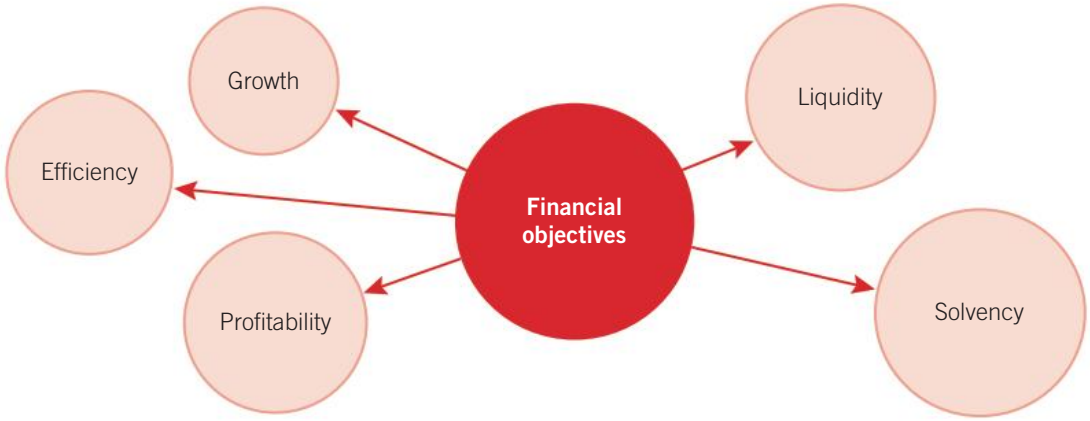


Source 9.3 Finance must support each of the other business functions.



Source 9.4 Financial objectives

Profitability

Profitability is the most recognisable financial objective, as nearly all businesses will seek to increase profit through increased sales and decreased costs. Owners contribute financial resources to a business when it is established and throughout the business's lifetime. This is called capital. The return on the owners' investment in the business is the amount of profit returned to the owners or shareholders and is expressed as a percentage of their original investment.

The income statement of a business (a summary of all its revenue and expenses over a period of time) will list two types of profit: **gross profit** and **net profit**.

Gross profit is the profit made on the sale of goods after paying the cost of purchasing them from the wholesaler and transporting them to the business ready for sale (that is, sales revenue minus cost of goods sold). Alternatively, it is the cost of buying the inputs that are transformed into goods for sale. The gross profit figure does not take into account any other expense, and is sometimes referred to as mark-up.

Profitability The earnings of the business after expenses have been paid.

Gross profit The revenue remaining after paying the cost of goods sold; that is, the expenses of purchasing the goods wholesale (wholesale cost) and transporting them to the business ready for sale (freight or cartage inwards).

Net profit The final amount of revenue remaining after all expenses have been paid.

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Source 9.5 Summary of objectives of financial management

Objective	Definition	Data from financial reports	Analysis
Profitability	The earnings of the business after expenses have been paid	Gross profit (income statement)	Formulas are calculated as a percentage of sales. Generally, if revenue is greater than expenses, the business has made a profit. If revenue is less than expenses, it has made a loss.
		Net profit (income statement)	
		Earnings before interest and tax (EBIT) (income statement)	
Efficiency	How much of total revenue is spent on expenses	Expenses (income statement)	The proportion of sales revenue that is used for expenses.
Growth	The size of the business compared to its competitors in the same market	Market share	Compare business sales to total market sales. The higher the percentage, the larger is its market share.
		Number of outlets	
Liquidity	The ability of the business to pay short-term liabilities using its current assets	Current assets and current liabilities (balance sheet)	Compare current assets and current liabilities. If current assets are greater than current liabilities, the business has positive liquidity. If current assets are less than current liabilities, it will not have enough money to pay its short-term bills as they fall due.
Solvency	The ability of the business to pay both short-term and long-term liabilities as they fall due	Current assets, current liabilities, non-current assets and non-current liabilities (balance sheet)	Compare total assets and total liabilities. If the business is able to pay its short-term and long-term debts as they fall due, it is solvent. It needs to be able to make its repayments for debt finance.

Net profit is the final amount of revenue remaining after all expenses have been paid. Source 9.6 shows how net profit is determined.

Profitability is measured using net profit. A financial manager is able to work out whether the business is making enough profit from its investment in assets by calculating and analysing the gross profit ratio and the net profit ratio. Earnings before interest and tax (EBIT) is a more precise measure of profitability than is net profit. This is because it measures the profit made directly from the operations of the business.

Owners can reinvest the profit into the business or withdraw part or all of their share of the profits from the business. For example, one owner in a partnership invested $100 000 of her money when the business was established. At the end of one year, the owner receives $25 000; her return is 25 per cent. The business would be judged a success if the return was greater than the amount that could have been made from safer alternatives, such as keeping money in a savings account or investing in property.

Growth

A business that grows will increase its size and therefore its potential profitability in the long term. Increased output will ideally result in more sales, which will increase revenue and therefore profit. This also depends on expenses being well managed. If a business grows too fast, it could

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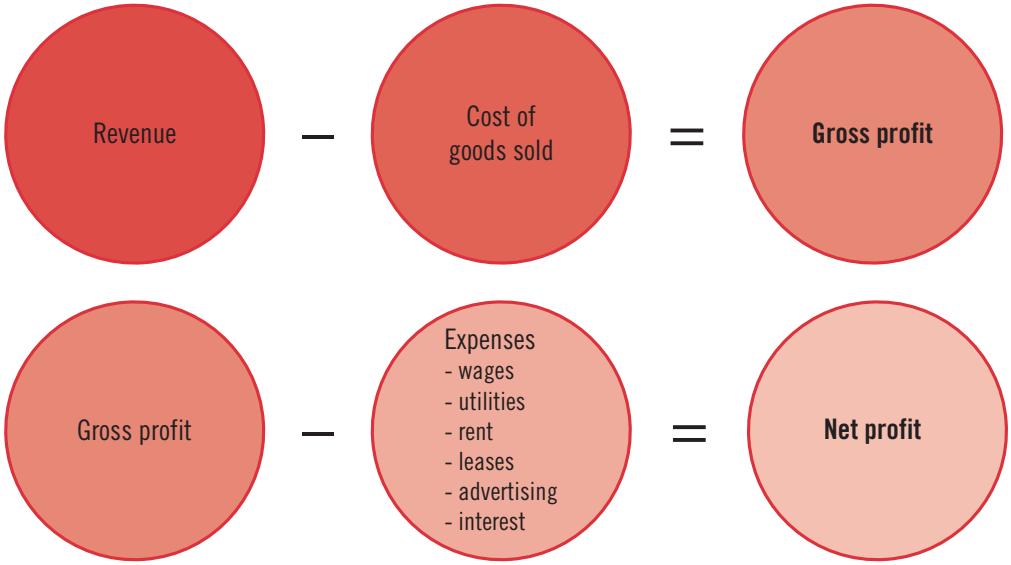

Source 9.6 Calculating gross and net profit

cause liquidity or cash flow problems. **Growth** can be achieved by:

- increasing the physical size of the business by expanding or moving to a larger office or factory to increase operations
- increasing the value of the assets in the business (for example, by having more stock in a retail store or more equipment on a farm)
- increasing sales and profits
- increasing market share through business expansion
- opening more stores, branches or offices in Australia or overseas
- taking over or purchasing a competitor
- merging with another business in the same industry
- diversifying by buying other businesses
- expanding the business's range of products.

Efficiency

Efficiency is related to profitability because a business will be able to increase its profit when it can decrease its costs. In many service-based businesses, the largest expense is usually the wages and salaries of staff. In modern manufacturing businesses, the largest expense will be raw materials and equipment. Efficiency may be calculated using an expense ratio, such as total expenses divided by total sales. The result is written as a percentage. The lower the result, the more efficient is the business. This means the business is able to generate more sales while spending less money.

Efficiency is also gained if a business can achieve the same level of profit from a smaller amount of inputs. For example, a small manufacturing business may have the latest equipment, allowing it to make the same level of profit as a larger manufacturer that has older, less technologically advanced equipment. In this example, the small business would be considered more efficient than the large business. Another measure of efficiency is the business's ability to collect its **accounts receivable**. Many businesses sell goods and services to customers on credit to those clients with whom they have a good relationship. The customer receives a bill, or **invoice**, and is required to pay by a specified date, such as in seven or 30 days' time or at the end of the month. How long a business is given to pay will depend on the credit terms the seller allows. The accounts receivable turnover ratio calculates how many days, on average, it takes customers to pay their invoices. The shorter the average time, the more efficient the business is in collecting its accounts receivable because it is receiving money owed to it much more quickly.

Growth The increase in the size of the business, often leading to an increase in profit

Accounts receivable A current asset that represents money owed to the business in the short term. This money is owed to the business by customers who are yet to pay for goods or services they have already received. Accounts receivable is also known as debtors.

Invoice A bill sent to a customer requiring payment by a specified date. Invoices are primary documents in accounting because they are records of credit sales.

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Business Bite

In 2007, Apple presented its first iPhone to the marketplace. Each year since then, Apple has brought out a new version of its mobile phone with improved features. Over these years, Apple research has increased the functionality of its iPhone while keeping the price relatively affordable for its target demographic. Apple has continuously improved the speed of its phone, its memory capacity, the life of its battery, use of touch controls and resolution of its screen and photography. The camera and its video applications have become more efficient and easier to use. Screen size has increased as well as being more scratch- and water-resistant.

Each year, customers line up to purchase the newest model. Operations, marketing, human resources and finance have worked interdependently to develop the iPhone product, which currently provides about 59 per cent of Apple product revenue.

Source 9.7 Between 2007 and 2020, Apple released 20 iPhone models.

Review 9.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Explain the impact that increasing efficiency will have on a business's profitability.
2 Analyse how sales can be used as a measure of a business's growth.
3 Identify other ways that growth could be measured.
4 Explain why objectives of growth and profitability may cause conflict in the short term.

The following questions refer to the income statement below.
Income statement for Elfie's Corner Store

Income	**$**	**$**
Sales	94 500	
Cost of goods sold	58 200	
Gross profit		36 300
Expenses		
Rent	21 100	
Electricity	820	
Telephone	1100	
Wages	5200	28 220
Net profit		8080

Continued →

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5 Calculate the revenue that this business achieved.
6 Calculate how much Elfie has paid for the inventory she actually sold.
7 Deduce whether Elfie owns the premises and explain how you came to this conclusion.
8 Calculate the profitability of this business. (Hint: see Source 9.6)
9 Calculate the efficiency of this business. (Hint: [expenses ÷ sales] × 100)
10 Discuss the profitability and efficiency of this business.

Liquidity

Liquidity is a measure of how quickly a current asset, including stock and accounts receivable, may be converted into cash, and therefore determines the ability of the business to pay short-term debts as they fall due.

Current assets are assets that are expected to be used, sold or converted to cash within 12 months, such as:

- cash in the business's bank account, the most liquid asset
- accounts receivable, which is a relatively liquid asset as **debtors** are expected to pay their accounts within a short time (credit period)
- inventory, which may take some time to sell and convert to cash, making it the least liquid of the current assets
- any expenses that have been paid in advance.

Source 9.8 A business should be in a financially stable position so that it can pay its creditors on time.

Financial managers are interested in liquidity because businesses need to know how quickly they can convert an asset into cash in order to pay a **liability**. **Current liabilities** are debts that are due to be paid within 12 months. **Accounts payable**, bank overdrafts, short-term loans, interest payable on loans and salaries payable are all current liabilities. Liquidity provides a measure of how successfully a business manages its working capital by maintaining current assets that are greater than current liabilities, and therefore having enough short-term assets to pay short-term debts as they fall due. A financial objective is to keep the business in a financially stable position in the short term by keeping it liquid.

Businesses A and B in Sources 9.9 and 9.10 illustrate the breakdown of different current assets, which is an important factor when determining liquidity.

Liquidity A measure of how quickly an asset may be converted into cash that therefore determines the ability of the business to pay short-term debts as they fall due.

Current assets Assets (such as cash in the bank, accounts receivable and stock) that earn revenue for a business in the short term; usually within 12 months.

Debtors The businesses or individuals that owe money to a business. Also known as accounts receivable.

Liability The amount of money owed to individuals and businesses (creditors; for example, suppliers or institutions such as a bank).

Current liabilities Money that is owed to an external business or person that will be repaid in the short term; usually within 12 months.

Accounts payable The money a business owes to its suppliers and service providers. Accounts payable is also known as creditors or trade creditors.

Source 9.9 Balance sheet for Business A

Current assets	$	Current liabilities	$
Cash	1 000	Bank overdraft	1 000
Inventory	5 000	Accounts payable	2 000
Accounts receivable	3 000		
Prepaid expenses	1 000	Salaries payable	2 000
Total current assets	10 000	Total current liabilities	5 000

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Source 9.10 Balance sheet for Business B

Current assets	$	Current liabilities	$
Cash	4000	Bank overdraft	2000
Inventory	3000	Accounts payable	3000
Accounts receivable	3000		
Total current assets	10000	Total current liabilities	5000

Business A has twice as much finance available to pay all its current liabilities: $10 000 in current assets compared with only $5000 in current liabilities. However, if all suppliers have to be paid immediately, the business does not have enough cash on hand to pay them.

Creditors The businesses, financial institutions and individuals to which a business owes money. Also known as accounts payable.

A business that cannot pay its liabilities on time may find:

- electricity, telephone or water services are disconnected
- suppliers won't wish to trade with it or may sell based on cash on delivery
- its credit rating may fall, which will affect its ability to obtain loans in the future
- it will incur late payment fees and increased costs
- it may have to increase long-term debt to raise cash, putting the business in a less financially stable position.

The liquidity position of Business A could be improved. Examine Business B and note the difference in its liquidity.

Business B has better liquidity than Business A because it has more cash on hand. It has invested less money in inventory, holding a lower level of stock. Having less inventory can reduce storage costs. More money is held as available cash in the business's bank account.

Business B can afford to pay either the bank overdraft or **creditors** (accounts payable) and will still have cash left over.

However, a business with very high liquidity is not necessarily more successful than one with lower liquidity. If the financial manager decides to keep a lot of cash in the business bank account, he or she will be criticised by the owners for being too cautious and not using finance effectively. Having too much cash saved is a waste of financial resources and a loss of potential profits. This cash could be put to better use in the business rather than earning a very small amount in interest from a bank.

Source 9.11 Having too much cash saved is a waste of financial resources and a loss of potential profits.

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Finally, liquidity is affected by the ability of the business to collect its accounts receivable. If the business is unable to collect these debts in a short time, it cannot convert accounts receivable to cash very quickly. Despite having a good measure of liquidity, the business may find that it does not have enough physical cash to pay liabilities.

Successful financial management involves monitoring costs on a continuous basis through budgets and the control of the liquidity of the organisation to minimise the cost of having too much cash available to pay liabilities or the risk of not having enough cash to pay creditors on time. Through careful monitoring, management can calculate the amount of funds available for the day-to-day running of the business, its net working capital.

Liquidity is calculated by using the liquidity (or current) ratio. The formula is:

Liquidity ratio = current assets ÷ current liabilities

Working capital ratio = current assets : current liabilities (e.g. 2:1)

Net working capital = current assets – current liabilities

Solvency

Solvency is the ability of the business to meet its financial obligations in the long term (that is, greater than 12 months). The business is able to repay all its debt. It is a measure of whether a business is financially stable. Borrowed (debt) finance may be used to purchase expensive assets such as machinery or a factory that is needed by the business. These assets will be used to earn revenue through the production and sale of outputs and hopefully generate more than enough profit to repay the loans. As long as the business can continue to make repayments by the due date, it will remain solvent and be financially secure. When interest rates on loans are low, the cost of the debt is low. Most businesses have a mixture of debt and equity financing. As loans are repaid, the ratio of debt to equity falls, reducing the level of **gearing** in the business. Gearing (or leverage) tells you how much debt finance the business has acquired to fund its operations compared to its level of equity finance.

Solvency The ability of a business to pay both short-term and long-term liabilities as they fall due. It is a measure of whether a business is financially stable.

Gearing How much debt finance the business has acquired to fund its operations compared to its use of equity finance.

Activity 9.1
Comprehension and application

1 Explain how return on capital can be used as a measure of profitability.

2 You are the financial manager of Protection Gear Pty Ltd, an expanding retailer of off-road gear for all ages that will protect riders when riding their dirt bike or motorcycle. Write financial objectives for this business as they should appear in the business plan. Use the SMART system:

S = specific – objectives need to have detail about what is planned to be achieved
M = measurable – the financial manager needs to be able to calculate performance and determine whether the objectives have been reached
A = achievable – it must be possible to reach the objectives given the business's resources
R = realistic – it must be possible to reach the objectives given the business environment
T = time – a time limit needs to be set for when the objectives are to be met.

Here is an example to assist you: Protection Gear Pty Ltd's strategic goal is to achieve a net profit ratio greater than 15 per cent for the next financial year. Financial objectives for Protection Gear Pty Ltd could include:

- To increase online and retail store sales by 20 per cent within six months.
- To decrease the exchange period from 60 to 20 days.

Continued →

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Activity 9.1 *continued*

- To increase the accounts receivable turnover ratio for store sales to 11 times per year.
- To ensure all online sales are paid for before shipment with adequate credit card controls in place.

3 Create financial objectives to achieve improvements in the following:
   a profitability
   b growth
   c efficiency
   d liquidity
   e solvency.

4 Explain why having many current assets is not a guaranteed solution to maintaining liquidity.

Short term and long term

Even though the business identifies its goals and individual department objectives, it must often prioritise them, as they may not always be able to be achieved at the same time. In fact, at times objectives, and even goals, may conflict in the **short term.**

Short term In less than a 12-month period.

Long term Longer than a 12-month period.

A business may wish to source the cheapest funds available for the finance necessary to pursue its goals; however, these funds may not provide it with a long enough repayment period for financial management. A business may need its costs spread over a longer period of time for the venture to be viable.

In the short term, costs may increase and profits decrease due to a policy of growth and expansion through the introduction of new technology requiring additional debt finance. In the short term, the business will have to successfully manage its cash flow in order to make the additional repayments for the new debt. In the long term, increased sales and improved efficiency may lower overall costs and provide increased profits. Also, if goals are deemed unattainable, some objectives may need to be eliminated or adjusted.

Overall, the **long-term** goal of financial management is to increase the wealth of the owners of the business. The strategic financial decisions may relate to expansion, takeover of another business, decreasing debt levels and so on. However, if another business goal is to be environmentally responsible, then the financial manager may not be able to choose the least expensive method of waste disposal as it would be bad for the environment. This decision conflicts with maximising profits in the short term and in the long term. Consumers can reward businesses that use socially responsible methods of production by purchasing the products of that business.

Consumers can also turn to a business's competitors if a business is not seen to be environmentally responsible. If sales drop, so do profits. In this case, stakeholders may come into conflict and the managers will need to negotiate to achieve an acceptable result overall.

Businesses must prioritise their goals and may need to align their order of importance with the business environment and society's values. Businesses today see the triple bottom line as a more realistic and acceptable measure of success in the long term. The triple bottom line includes:

1 financial achievements such as profit levels and business growth
2 social concerns through the business's impact on people inside and outside the business, such as working conditions and contribution to the community
3 effects on the natural environment (for instance, improving or at least limiting or reducing its impact, such as pollution levels). A business can, for example, reduce its environmental impact by encouraging employees to recycle.

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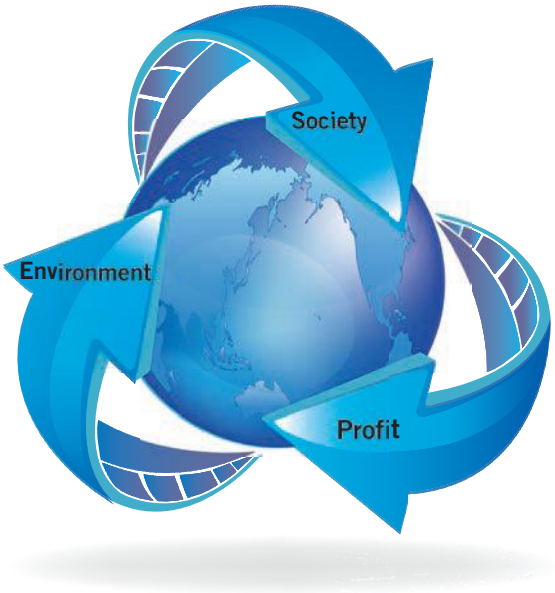


Source 9.12 A triple bottom line implies that a company can be managed so that it not only makes a profit but also improves people's lives and cares for the planet (i.e. profit, society, environment).

9.3 Interdependence with other key business functions

The main functions that a business performs are operations, human resources, marketing and finance. Middle management develops short-term plans known as tactical plans, which are based on information provided by each of the business's functions. These plans enable the business to achieve the goals set out in its strategic plan. All the functions of the business must work together and rely on each other for the business to be successful; that is, they are interdependent.

As the business grows and undergoes changes, the coordination of the separate functions becomes more complicated and the skills of management become increasingly important. It is essential that all internal stakeholders understand how the business works and know what the business hopes to achieve.

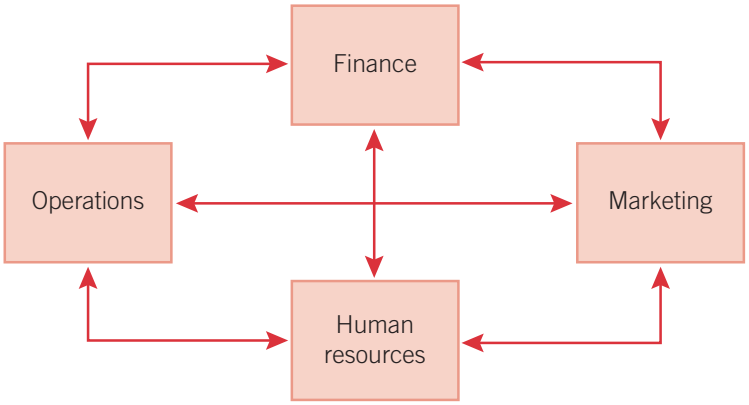
Communication between departments must be effective, clear and complete. In order to be successful, management needs to be able to see the business as a whole unit with many individual parts operating together (much like the organs in the human body).

Finance and operations

The financial manager must allocate adequate funds to the operations department to be able to supply its product successfully. The financial manager will also need to develop budgets and cost controls for operations, encouraging it to minimise expenses and work efficiently. Operations should use its resources to achieve maximum output and minimise waste, thus ensuring high productivity, efficiency, profitability and, through marketing, increased sales revenue.

Finance and marketing

A business has only a set amount of funding. If marketing is provided with large amounts of funding, so that operations – which provides the core product – does not have enough money to keep up supply, then the money spent on



Source 9.13 Interdependence of business functions

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marketing will be wasted. Finance needs to determine the best allocation of its funds to allow all functions to operate successfully. If marketing has enough funds allocated in its budget to develop a highly successful marketing campaign, then sales, market share and profitability will increase, which will push up the business's share price. This, in turn, will make it easier for the business to borrow funds in the future.

Finance and human resources

Human resources needs to make sure that it employs the best people to work for the business. Finance allocates funds in its budget to human resources to acquire, train, maintain and, if necessary, separate employees from the business. Human resources works with finance to determine the remuneration provided to staff members.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Business Bite

Businesses such as car sales yards, real estate agencies and even individual departments in large department stores often pay their employees a base salary and commission. Usually, the sales commission will be based on a strict criterion of a minimum number of sales or deals and, once achieved, the employee receives a commission payment of a fixed amount or percentage of sales value. A sales commission is an additional compensation or reward the employee receives for meeting or exceeding sales targets.

The marketing function would be recording sales details, the human resource function providing employee details, and finance would be calculating the commission earned. All of these business functions would need to work interdependently for the remuneration process to work fairly and efficiently.

Source 9.14 A sales commission is an additional compensation or reward the employee receives for meeting or exceeding sales targets.

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Chapter summary

The long-term or strategic role of financial management is to ensure that a business operates to provide a return on investment and continues to grow and meet its objectives.

Financial objectives are more detailed than strategic goals. They identify and support what the owners of a business want to achieve. Objectives will be developed for profitability, growth, efficiency, liquidity and solvency. A financial manager will use a number of measures to determine whether the objectives have been achieved for each of these categories.

Profit is what is left over from revenue after all expenses have been paid. Retained profit is reinvested back into the business as additional equity, adding to the owners' original investment. Profit may also be distributed to owners and shareholders as their return on investment. Profitability is measured by the gross profit and net profit earned in a financial year.

A business that grows will increase its long-term profitability. Growth can be achieved, for example, by increasing market share and total sales.

Efficiency is achieved when a business can generate a greater output with the same level of inputs (or the same output using less inputs). Efficiency is related to profitability because a business will be able to increase profit when it reduces the costs of its inputs.

A business needs to hold adequate levels of liquid assets. The most liquid asset is cash. Current assets are more liquid than non-current assets. Financial managers are interested in liquidity because it shows how well working capital is being managed and whether the business can meet its short-term obligations.

Solvency is the ability of the business to pay all its debts as they fall due. The higher the gearing or total debt compared to equity finance, the greater the financial burden the firm has to deal with, and the greater the risk involved.

In order to achieve long-term business objectives, the business must achieve its short-term objectives. Overall, the objective of financial management is to increase the wealth of the owners.

The main functions of a business include operations, human resources, marketing and finance. These functions are interdependent and must rely on each other for the business to be successful and achieve its goals and objectives.

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End-of-chapter tasks

Chapter revision tasks

1 Rewrite the following paragraph using the words listed in the box to fill in the blanks.

Profitability	Solvency	Growth	Current liabilities
Efficiency	Profits	Liquidity	Funds
Goals	Liquidity	Objectives	Owners

The strategic role of financial management is to ensure that the business has enough _____ to meet its needs and provide a return to its _____. The finance function establishes the financial _____ that it will need to achieve to enable the business to achieve its strategic _____. The business pays tax on its _____ for each financial year. Financial managers will determine their objectives which include _____, _____, _____, _____ and _____. Some assets will need to be more liquid in the short term in order for the business to pay _____ as they fall due. This will ensure that the business can maintain its _____.

2 Match the following terms with their explanations.

Term	Explanation
Liquidity	To provide a return on the owner's initial investment
Growth	To be able to pay all debts as they fall due
Profitability	To achieve a larger level of profit from a smaller amount of funds
Solvency	To increase the size of the business compared to its competitors
Efficiency	To be able to pay short-term debts as they fall due

Multiple-choice questions

1 Which objective of financial management is concerned with the ability of a business to manage its revenue and expenses?

A Profitability
B Liquidity
C Efficiency
D Growth

2 What is solvency used to determine?

A The profitability of a business
B The ability of a business to repay its short-term debts
C The ability of a business to repay its total debts
D The cost of goods sold

3 The financial manager of Alexandria's Coffee House has decided to monitor and control all areas of spending in the business. What is the purpose of this?

A To increase spending
B To decrease expenses
C To increase solvency
D To increase liquidity

4 Net working capital is:

A current assets ÷ current liabilities.
B current assets + non-current liabilities.
C current assets – current liabilities.
D current liabilities – non-current liabilities.

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5 Which of the following is generally the most liquid asset of a business?

A Accounts receivable
B Inventory
C Property
D Cash

6 Of the following measures of profitability, which will provide the most precise measure of the profitability from the operations of the business?

A Earnings before interest and tax
B Earnings after interest and tax
C Net profit
D Gross profit

7 What does 'efficiency' refer to in the financial management of a business?

A Increasing the sales of a business
B Ensuring there are enough liquid assets in the business
C Reducing expenses to increase profit
D Keeping cost of goods sold low and gross profits high

8 Why is the effective management of a business's financial resources important in the long term?

A It encourages a business to develop expensive marketing strategies.
B It is through the effective use of financial resources that a business is able to achieve its financial objectives.
C It is through the use of financial resources that a business is able to obtain the best inputs.
D It allows a business to acquire highly skilled and motivated employees.

9 Roberto is the financial manager of Hetaphone Pty Ltd. His main role is to ensure that short-term creditors are paid on time. Which financial objective is Roberto mainly concerned with?

A Profitability
B Growth
C Solvency
D Liquidity

10 A business is insolvent if it can:

A pay all of its short-term liabilities as they fall due.
B pay all of its short-term and long-term liabilities as they fall due.
C not pay all of its current liabilities as they fall due.
D not pay its short-term and long-term liabilities as they fall due.

Short-answer questions

1 Outline the five objectives of financial management.

2 Distinguish between goals and objectives, using examples.

3 Explain the relevance of short-term and long-term time periods in the financial management of a business.

Extended-response question

Investigate why it would be important for a business to understand the potential conflict between the main objectives of financial management.

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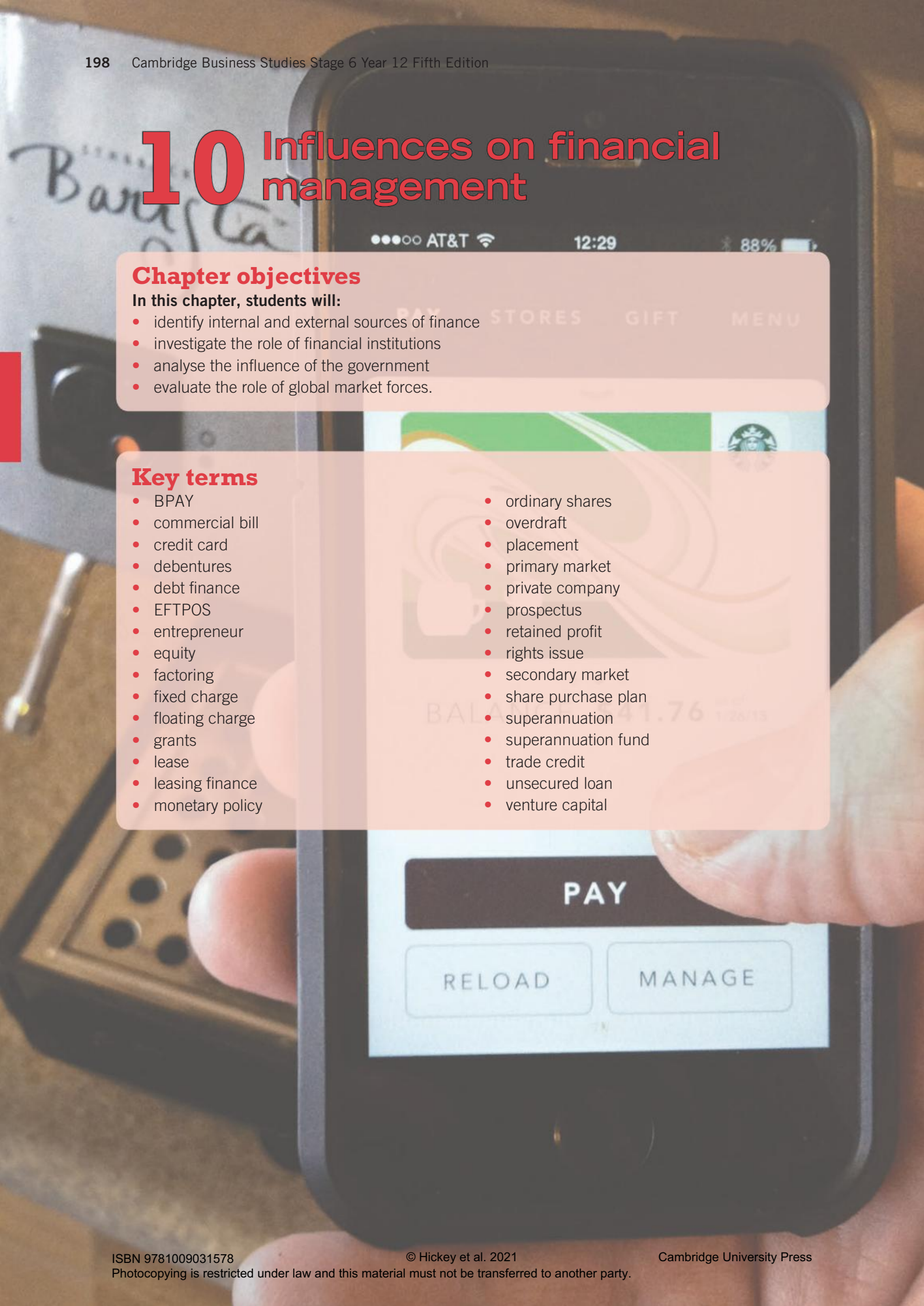
10 Influences on financial management



Chapter objectives

In this chapter, students will:

- identify internal and external sources of finance
- investigate the role of financial institutions
- analyse the influence of the government
- evaluate the role of global market forces.

Key terms

- BPAY
- commercial bill
- credit card
- debentures
- debt finance
- EFTPOS
- entrepreneur
- equity
- factoring
- fixed charge
- floating charge
- grants
- lease
- leasing finance
- monetary policy
- ordinary shares
- overdraft
- placement
- primary market
- private company
- prospectus
- retained profit
- rights issue
- secondary market
- share purchase plan
- superannuation
- superannuation fund
- trade credit
- unsecured loan
- venture capital

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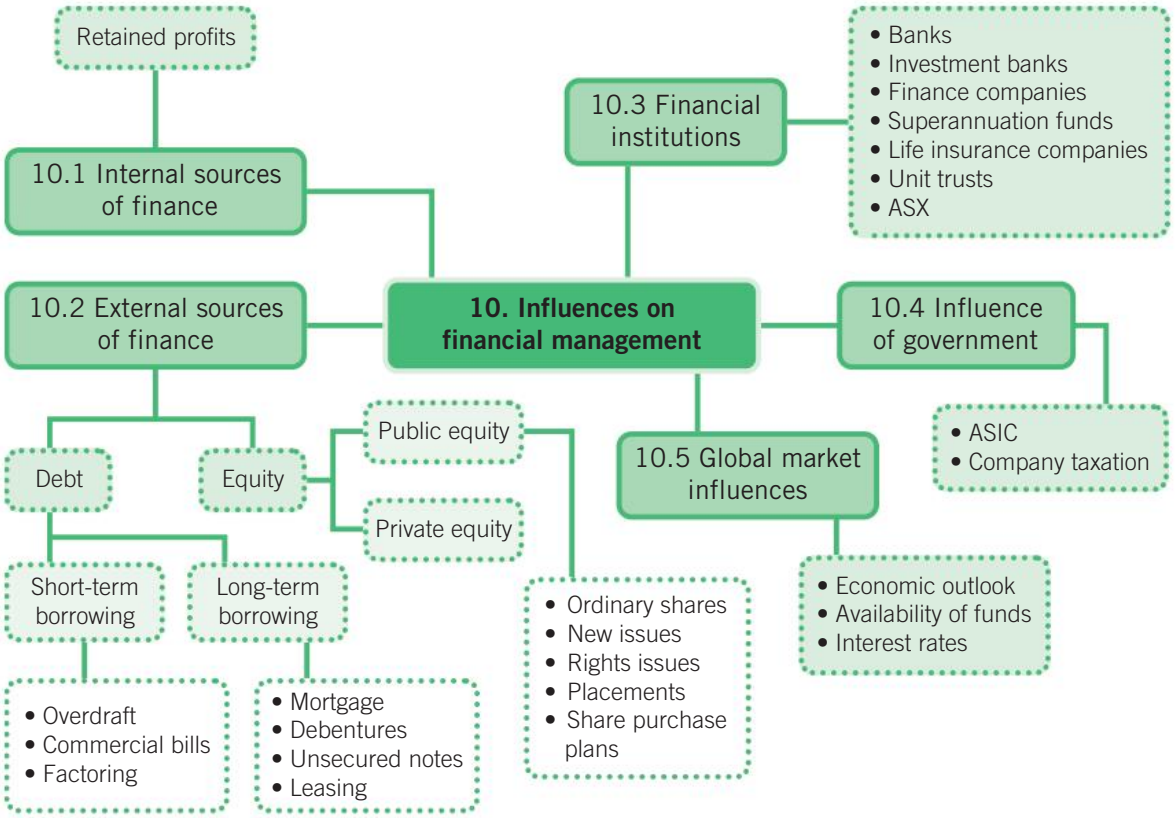
10.0 Introduction



Source 10.1 Influences on financial management concept map

Financial management involves planning, organising, monitoring and controlling the monetary resources of a business in a way that will fulfil its financial objectives and enable the business to achieve its strategic goals. It involves the efficient and effective management of the business's funds achieved within the parameters set by the business environment.

Businesses today are not only affected by local influences but also by national and international factors. Businesses operate in a global business environment. They are part of the worldwide economy and finance is no exception. Today's business environment is a global, dynamic and constantly changing marketplace. Even foreign nations and their governments can influence what a business produces, how it produces and how it distributes its export products. Global factors can influence the way finance is sourced and managed by a business. The key areas of influence are shown in Source 10.1.

People who wish to set up their own business will need to obtain funding to make their idea a reality. When the business is in operation, additional funding may be required for the development of new products, global expansion or even mergers and takeovers. Whatever the reason for needing additional funds, as we will see in the following section, businesses may acquire these funds from internal and external sources. However, the business's legal structure and the intended use of the funds must be matched to the right source of the funds.

An **entrepreneur** will need to obtain the necessary finance whether they wish to purchase an existing business, start a business from scratch or enter into a franchise agreement. Although costs vary from industry to industry, opening a business can be very expensive. Let's assume that it costs $100 000 to create and open a restaurant. Where can someone obtain $100 000?

Entrepreneur A person who uses initiative to take a calculated risk to start a new business.

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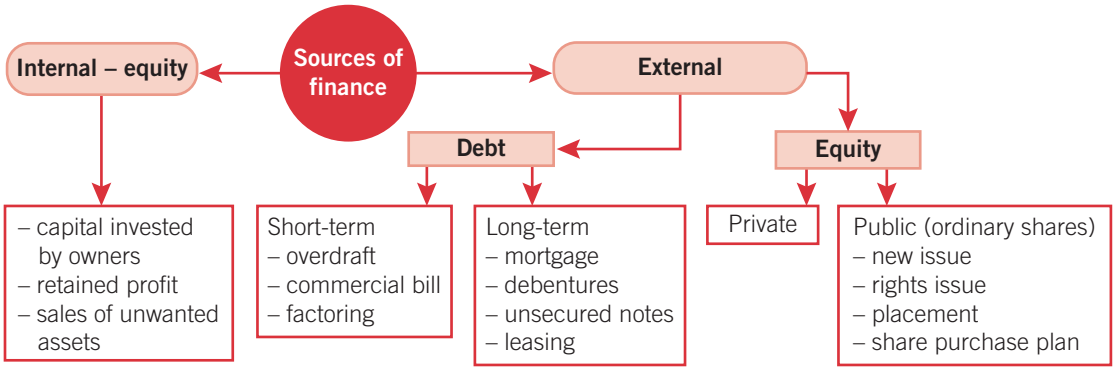

Source 10.2 Sources of finance

Digital quiz
Please see the Interactive Textbook to access digital activities.

10.1 Internal sources of finance

Internal sources of finance are from inside the business and are recorded under Equity in the balance sheet. These sources can include the capital contributed by owners when the business began, reinvested profits and the sale of an unwanted business asset.

Owner's equity or capital

An owner can invest their own money into the business. This money may be:

- personal savings
- inheritance
- gift from parents
- payout from being made redundant
- personal loan or mortgage loan using the family home as security.

The owner of a sole trader or partnership deposits cash into the business's bank account when it is started. As the owner has contributed this money when the business began, this source of finance is called capital. This can also be called proprietorship or proprietor's funds. If the business has an incorporated legal structure such as that of a private company, then it could be known as shareholders' funds. This capital is recorded under Equity, as it represents the owner's financial claim on the assets of the business.

Retained profit Net profit that is reinvested into the business. Retained profit is added to equity because it increases the owner's claim on the assets of a business.

Retained profit

Retained profit is another common type of internal equity finance. Sometimes retained profit is called 'undistributed profits'. If the business makes a profit, the owner may decide to only take part of this as their reward for entrepreneurship and reinvest the remainder back into the business. In this situation, the business has finance from two internal equity types: the owner's capital contribution and retained profit.

Sale of an unwanted or unproductive asset

Additionally, the business may benefit from the sale of an unwanted or unproductive asset, such as outdated machinery sold for scrap metal or duplicated assets acquired through a merger and unnecessary after the merger. The funds from the sale are paid to the business and are thus available for its use. In this case, there is no interest to be paid, no repayment necessary and no loss of control for the owner.

Review 10.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Outline the sources of equity for a new business owner.
2. Discuss the advantages and disadvantages of selling an unwanted asset to gain funds for the business.

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Source 10.3 An owner may decide to reinvest profits back into the business.

10.2 External sources of finance

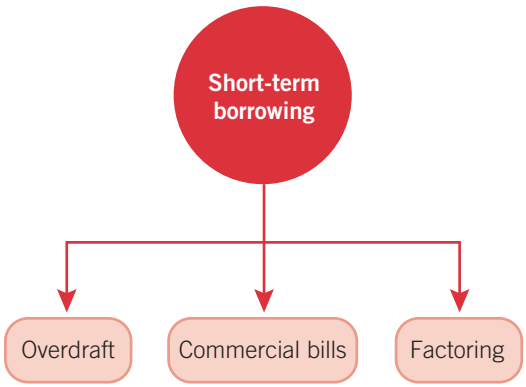
There are a number of external sources of finance available to a business. These usually involve some type of loan (borrowed funds) and are therefore called **debt finance**.

Debt

Debt finance is any money that has been borrowed. These borrowed funds will need to be repaid within a specified period and incur interest charges and administration fees. The costs of this type of finance are a tax deduction for the business. Debt finance is generally categorised according to the term of the loan (that is, its repayment period). Generally, a short-term debt or current liability would be repayable within 12 months. By contrast, a long-term loan or non-current liability would be repaid over a period longer than 12 months. There are also sources of finance that are external to the business but which are not a loan. These include venture capital and grants.

Short-term borrowing

A business should use short-term borrowing to solve short-term problems, such as a cash flow shortage, to help maintain the liquidity of a business. The most common forms of short-term borrowing include an overdraft, commercial bills and factoring.



Source 10.4 Short-term borrowing

Overdraft

A bank **overdraft** gives a business flexibility to borrow money from a bank at short notice through the business's transaction account. A bank may allow a business to overdraw its transaction account up to a specified maximum limit as agreed between the bank and the business.

Debt finance Any type of loan that a business obtains that is issued with a promise of repayment on a certain date and at a specific rate of interest.

Overdraft A loan arrangement with the bank to draw more money than is in an account, up to a maximum limit. Interest is charged daily on the overdrawn balance.

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This overdraft facility allows a business to have a negative value in its account. Later, when the business receives cash from sales, money is deposited into the bank account, thereby reducing the overdraft. Overdraft facilities are very convenient, but can have very high costs (such as a high daily interest rate). Interest is charged on the overdrawn amount for the period of time that the account remains overdrawn. This form of debt finance can provide short-term finance for business requirements such as working capital, especially where a business is affected by seasonal fluctuations, such as a winter ski resort in the summer season. An advantage of a bank overdraft is that current taxation law allows interest paid to be claimed as a tax deduction, as it is an expense for gaining this finance and allowing the business to continue operating.

As an alternative to an overdraft, a business can have its own **credit card** on which to make purchases and pay expenses. A credit card provides a line of credit for the user of the card. This is becoming more common due to banks providing businesses with specialist credit cards that offer a lower rate of interest and loyalty programs.

Credit card A card that provides a line of credit to the user. The user can borrow money for payment to a merchant or as a cash advance to the user. A type of buy now, pay later plan.

Review 10.2

Comprehension

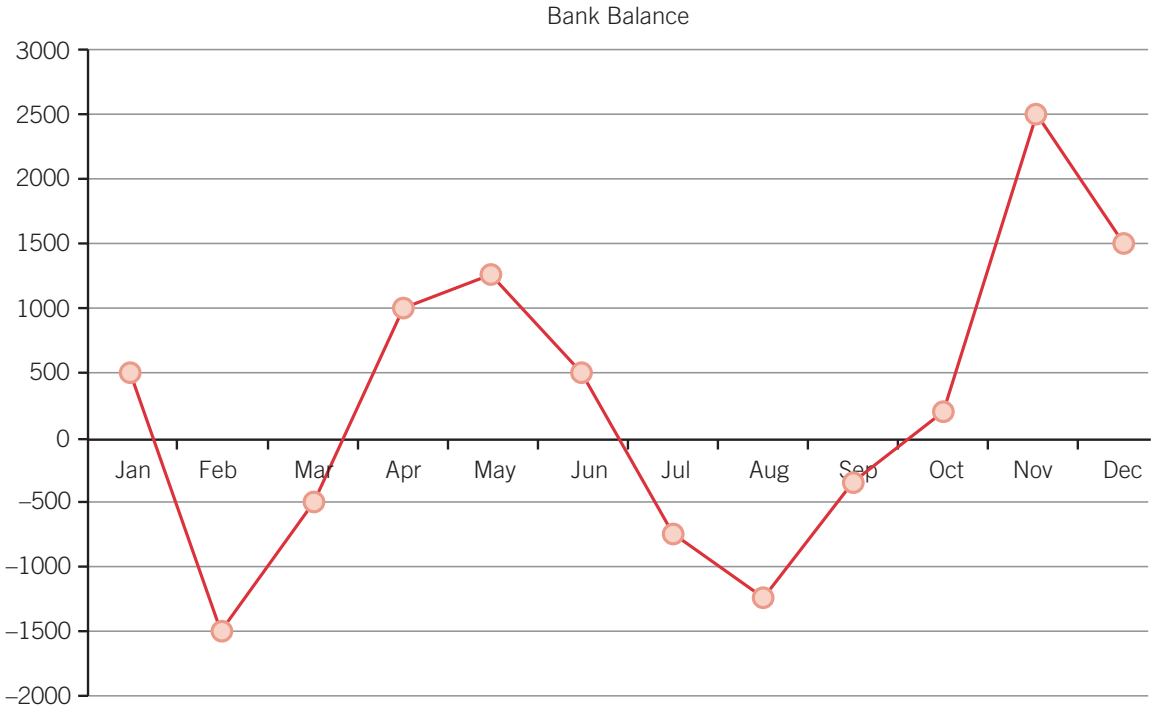
Answer these questions on paper or in the Interactive Textbook.

1. Explain why a business would need an overdraft.
2. Would a credit card be as useful as an overdraft for a business?

Ethical Spotlight 10.1

Fred and Allen often attend meetings interstate for the companies that employ them. They have both accumulated a lot of frequent flyer points in their own names. Is it ethical that Fred and Allen use these points to travel on personal holidays with their families, even though the business (and therefore the shareholders) paid for the flights that earned those points?

Source 10.5 An overdraft facility allows a business to have a negative value in its account.



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Commercial bills

A **commercial bill** (or bill of exchange) is a written order for a loan amount that is guaranteed by the business's bank. The money is borrowed from other companies that have surplus funds. Businesses and governments that need funds in the short term sell these bills. (This is like giving someone an 'I owe you' voucher.) The funds and interest will be repaid to a particular person or business on a certain day in the future. Usual terms are 30 to 180 days. Commercial bills are usually for hundreds of thousands of dollars and are used to finance expenses, such as payment to suppliers of materials and wholesale goods. These bills can be rolled over for extended time periods. They are often considered to be the cheapest form of finance. The bill needs to be reassessed each time it matures and the terms and interest recalculated for each rollover, thus retaining its short-term classification.

Bill of Exhange

Sydney, 1 April 2021 **Amount** US$ 378 000

At 60 days after sight **pay against this Sole Bill of Exchange**

to the order of Ourselves

the sum of US Dollars Three Hundred and Seventy-eight Thousand

for value Recived

To:
BestBank Ltd
Jalan Imbi
Kuala Lumpur
Malaysia

For and on behalf of:
EXWHYZEE Pty Ltd
H Franco
Henry Franco, Director

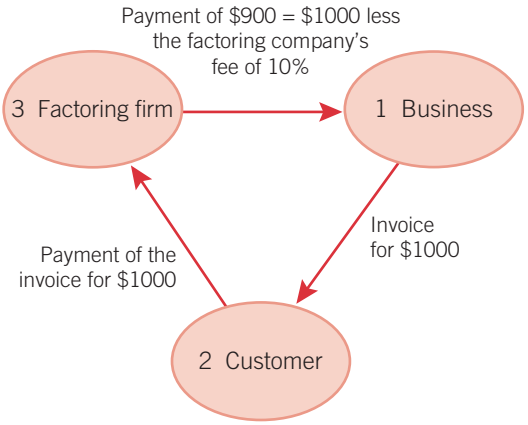
Source 10.6 A commercial bill or bill of exchange is a written order for a loan amount that is guaranteed by the business's bank, to be repaid to a particular person or business on a certain day in the future.

Factoring

Factoring is a source of short-term finance because it can be used to obtain cash reasonably quickly to improve cash flow. Factoring is the cash sale of a business's accounts receivable (or trade debtors) at a discount to a factoring company. This can be done on an ongoing basis.

The factoring company takes over management and collection of the unpaid accounts under terms agreed with the business. The factoring company pays the seller the value of the accounts receivable, less a commission or fee. The fee charged will vary with the amount of credit sales and the credit rating of accounts. Therefore, the greater the risk, the higher the fee.

Debtors pay the factoring company directly. Factoring is a method of improving a business's liquidity at the expense of some of its working capital in the short term. This is increasingly common in Australia, with many banks and finance companies setting up facilities for this service.



Source 10.7 A simple factoring arrangement

Reliable businesses can also use **trade credit** provided by their suppliers, which effectively allows them to use goods and services that they pay for at a later date. (Trade credit is a type of loan from a supplier, because payment to the supplier from the customer is delayed.) Good relationships with suppliers can result in trade credit that allows from 30 to 90 days of free finance. The supplier needs to have effective controls in place to monitor its accounts receivable in order to maintain its profitability.

Commercial bill (bill of exchange) An agreement to repay a short-term loan plus interest to the lender on a specific date.

Factoring Occurs when a business sells its accounts receivable asset to a specialist factoring firm to create cash inflow for the business.

Trade credit Money owed to a creditor for the purchase of supplies and services that have already been provided.

Video 10.1 Factoring

Ethical Spotlight 10.2

Some businesses or tradespeople may offer to accept a cash payment and not provide an official invoice or receipt for their work. What advantages and disadvantages could this result in for the customer, the business and even for the community?

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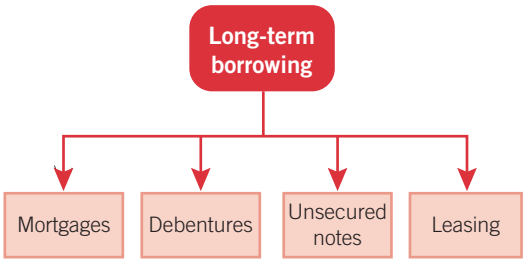
Long-term borrowing

A loan that has a term of repayment longer than 12 months would be considered a form of long-term debt finance. This is also known as a non-current liability. Businesses may take out term loans for 3, 5 or 10 years or longer. The more common forms of long-term borrowing for businesses include mortgages, debentures, unsecured notes and leasing. These are mainly used to fund non-current assets.



Source 10.8 Long-term borrowing

Mortgages

The most well-known type of debt finance is a business mortgage loan. Mortgage loans obtained from a bank or business lender have a long repayment period (or term) and can be used by entrepreneurs to purchase non-current assets such as a factory site or building. The property asset becomes the security for the repayment of the loan. Monthly repayments are made to repay the loan plus the interest. If the loan is not repaid, then the security may be sold by the lender to repay the loan. Business mortgage loans are typically very long-term, some being repaid over 15 to 20 years. In some cases, firms purchase property using an interest-only commercial loan and hope to gain capital gains when the property is resold and they move their production facility elsewhere.

Debentures A type of long-term debt finance that a business can acquire by offering a prospectus to the general public on the securities exchange. The business is offering an investment opportunity to people who want a higher return from a more risky investment.

Fixed charge Provides security over a specified physical asset.

Floating charge When the security is subject to day-to-day fluctuations, such as inventory.

Prospectus A company's invitation to investors to buy shares in the company. The prospectus is a brochure that describes the business and indicates what shareholders will receive if they invest by purchasing shares.

Debentures

Large, established companies can obtain finance by issuing **debentures**. Finance companies and other large firms are invited to invest in these businesses by lending them large amounts of money. These loans are used to buy buildings and equipment and are for a fixed amount, a fixed time period and at a fixed interest rate. A business that has lent the money becomes a debenture holder. Repayment is ensured by the appointment of a trustee who monitors the debenture-issuing business to ensure that it operates profitably and can therefore repay the loan and interest on maturity of the debenture. The debenture holder's funds are invested with the business as secured loans with the security in the form of a fixed or floating charge over the assets of the business. A **fixed charge** provides security over a specified physical asset. A **floating charge** is when the security is subject to day-to-day fluctuations, such as inventory. Debentures may be private or public issue. For a public issue, a company must issue a **prospectus**, which is also lodged with the Australian Securities and Investments Commission (ASIC). Public issue debentures may be traded on the securities exchange.

Unsecured notes

Unsecured notes are usually issued by finance companies to gain funds. They are not secured and do not provide any claim over the assets of the business. Therefore, they offer higher interest rates than debentures, reflecting the greater risk to the investor. The unsecured note issuer is only backed by its creditworthiness and good reputation. Unsecured notes are also called bonds. The borrower must pay a specified amount of interest, often quarterly or half-yearly, and repay the entire amount borrowed on maturity.

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Business Bite

Every five years, the All England Lawn Tennis Ground raises funds for capital expenditure by issuing Centre Court Wimbledon Debentures. For each debenture held, debenture holders receive:

- a Centre Court seat ticket for every day of the Championships
- a pass to the Centre Court debenture holders' restaurants and bars
- access to the debenture holders' car park, if they pay an extra fee.

Recent debenture series have been oversubscribed and preference given to existing debenture holders. New applicants have been selected through a ballot system. The prospectus for the 2016–20 series of Centre Court debentures was published in 2014, with 2500 debentures being issued. These debentures were bought for £50 000 and were resold at an average of £114 500.

In addition to the Centre Court debentures, there are also No. 1 Court debentures. These are issued at a different time from the Centre Court debentures, and are cheaper: in 2016, 1000 debentures for matches from 2017 to 2021 were available for £31 000 each (up from £13 700 in 2012).

No. 1539

All England Lawn Tennis Ground Limited.

This is to Certify that Percy Machin Esq. of Belmont Lobbs Lane Surrey,

Notwithstanding the redemption of the "B"

Debenture of the Company for £50, numbered 1539 is entitled to exercise his right to the allotment of a seat for each Annual Gross Court's Lawn Tennis Championship Meeting held up to and including the Championship Meeting in the year 1947 subject to the following Condition, namely:—

In the event of the Registered Holder hereof desiring the allotment of a seat for any such Championship Meeting as aforesaid, he shall detach each year such one of the coupons attached hereto as shall be available for use in respect of the Meeting aforesaid for which the Registered Holder hereof shall desire the allotment of a seat and shall forward the same to the Company on or before the 31st day of December in the year preceding that for which the seat is required, or on or between such other date or dates in each year as the Company may prescribe in writing to the Registered Holder and for this purpose strict observance of such date or dates shall be of the essence.

GIVEN under the Common Seal of the said Company this 20th day of August 1930

Secretary

Director

The rights under this Certificate can be transferred under common transfer form.

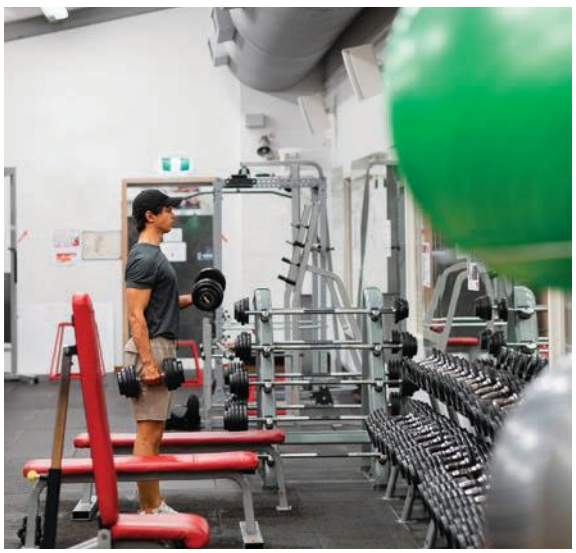
Source 10.9 The money raised is used to fund the continued development of the grounds and facilities.

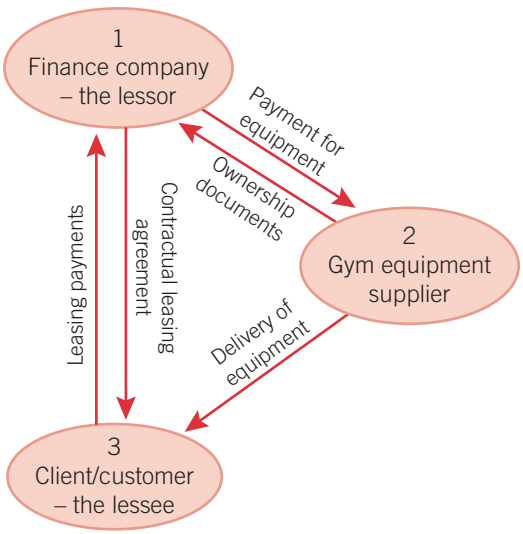
Leasing

Leases are similar to rental agreements. Businesses lease non-current assets, such as a company car or factory space, through a leasing company in return for payments to the owner. The business does not have to outlay the full value of the asset in one transaction. Instead, it rents the asset over an agreed period of

Lease A contract allowing use of another person's asset (such as land, equipment or services) for a specific period of time and at a set fee.

Source 10.10 A fitness centre may decide to lease gym equipment rather than purchasing it. On the last payment of the lease or residual price paid, the ownership is transferred to the lessee.





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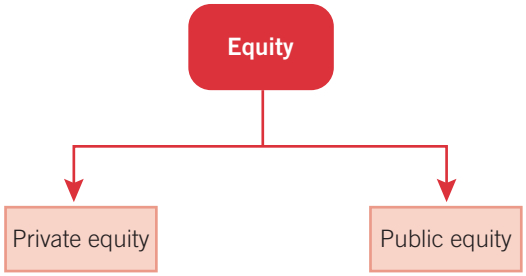
time with an ongoing, regular payment that allows it to use the asset, which is owned by another business. The firm has a contractual obligation to pay another business and therefore this is a type of debt finance. This agreement can provide tax advantages because the lease payments are usually tax deductible, as they are an expense for the business and are therefore included in the income statement. They are not shown in the balance sheet and do not affect the company's gearing or debt levels. At the end of the leasing period, the business may release the item, upgrade the lease for a different or newer item as for an operational lease, or offer to buy the leased item at the agreed 'residual value' negotiated at the start of a financial lease.

Equity

Funds invested in a business by its owners are called **equity** and usually refer to ownership of shares in incorporated businesses. This can relate to ordinary shares in public or private companies.



Source 10.11 Equity

Equity The owner's financial claim on the assets of the business. It is the original investment the owner made into the business by contributing capital or buying shares, plus any profit the business makes. Also called proprietorship or proprietor's funds.

Private company An incorporated business legal structure that has limited liability; however, it cannot advertise to the public for shareholders.

Ordinary shares Provide part-ownership in a public company; shareholders receive a dividend as their share of the business's profits.

Private equity

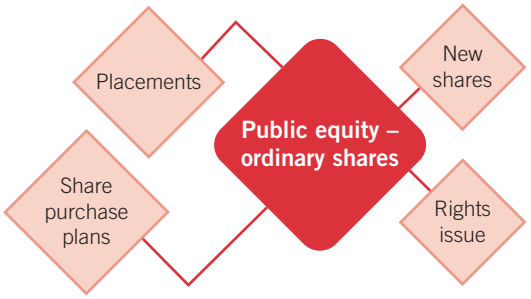
If a business is incorporated as a private company and does not wish to increase its level of debt, it can invite specific people to become part-owners by selling them shares in the business. The owners have gone outside the business to seek external equity finance. Using our restaurant example, let's assume that your business sells nine shares at $10000 each to nine friends. These shareholders will give you $90000. To this you add $10000, which is your share of the business, giving you the total finance ($100000) needed to open the restaurant. The advantage for the business is that the cost of the finance can be postponed, as shareholders will not need to be paid dividends immediately. However, with more owners the disadvantage is that ownership becomes diluted.

The original owners have less control because they now own a smaller share of the business. In addition, selling shares can be expensive and complex to organise. Private equity relates to a **private company** (having 'Proprietary Limited' or 'Pty Ltd' after its name) because the shares are not sold through the Australian Securities Exchange (ASX) and do not involve invitations to the general public to invest.

Public equity

Ordinary shares

Another form of incorporated business structure is a public company. (These have 'Ltd' after their name.) Public companies issue securities or shares to the general public through the ASX. **Ordinary shares** are the basic form of equity capital. Ordinary shareholders receive dividends as their share of the business profits. For public companies, shares may be acquired through a new share issue, rights issue, placements and share purchase plans.



Source 10.12 Public equity – ordinary shares

New issues

This first issue of shares is known as the primary market. A prospectus is issued and shares are made available on the ASX. For example, the amount of authorised share capital in the business, if 100000 shares are offered at $1 par

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value each (original face value or issue price) and all the shares are sold, is $100 000. Shareholders receive a dividend as their proportion of the company's profits. It is only when shares are sold for the first time that the business, or the owners of the business, actually receives the money. In the secondary market, when shares are resold, ownership of the shares changes and the previous owner receives the money.

Rights issues

In order to raise additional funds, a company may organise a **rights issue**. In this case, the existing shareholders of a company may be offered the purchase of additional shares in proportion to their current holdings of that company's shares. The shareholder is not obliged to take up the rights issue and may reject the offer, sell or transfer their rights to another shareholder.

A rights issue may be part of the company's original prospectus and therefore will not need to incur the expense of a new prospectus, only a written proposal to its existing shareholders.

Placements

Another method to raise additional funds that is more frequently used these days is to offer additional shares to specific institutions and specific investors who have the ability to invest large amounts of money. The company does this without a formal prospectus and does not need to obtain general shareholder approval. Through share **placements** a company can raise up to 15 per cent of its current capital base. These funds can be raised quietly, often within 24 hours and in large amounts such as $500 000.

Source 10.13 Shares are made available on the ASX (Australian Securities Exchange).

The company may wish to use these funds to significantly expand its activities, such as the takeover of a competitor. In this case, speedy acquisition of funds is essential. These companies may need to pay underwriters' fees in order to make up for any shortfall in the money raised. An underwriter is a business that agrees to buy shares not bought by investors.

Rights issue Issue of shares that is offered at a special price to existing shareholders in proportion to their current share ownership in that company.

Placement An additional share issue that is offered to specific institutions and specific investors to raise up to 15 per cent of the business's current capital base.

Business Bite

During difficult financial times, the ASX and ASIC work together to adjust their rules to better cater to the financial marketplace and allow business to benefit from institutional capital raising. For example, in April 2020, temporary initiatives such as the following were put in place:

- ASX listed companies did not need to seek shareholder approval for rights issues due to the difficulty of obtaining underwriting and determining issue prices.
- Temporary extra placement capacity was increased from 15 per cent to 25 per cent. This requires a follow-up pro rata entitlement offer or offering a share purchase plan at a price lower or equal to the placement price.
- The ASX allowed two consecutive trading halts (four trading days).
- For a short time and in specific cases, placements, rights issues and share purchase plans would be allowed without a prospectus.

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Share purchase plans

Share purchase plans allow existing companies to issue a maximum of $15 000 in new shares to each existing shareholder at a discounted price, without issuing a prospectus. Each share is offered at below the current share price. Permission is required from ASIC, is relatively inexpensive, is quick and benefits both the company and the investor. In order to proceed with a takeover, funding would need to be acquired very quickly.

Share purchase plan Companies can offer up to $15 000 in new shares to each existing shareholder at a discounted price.

Review 10.3

Comprehension

Answer this question on paper or in the Interactive Textbook.
Copy and complete the following summary table for external equity.

Incorporated business	Equity type	Target group	Characteristics
Private company	Shares		
Public company	Ordinary shares		
	New issue		
	Rights issue		
	Placements		
	Share purchase plan		

Business Bite

IOOF Holdings Limited, a financial adviser and distribution service provider, completed an institutional placement of about 43.5 million shares to raise $461 million in October 2017. A further $100 million was to be raised by a share purchase plan, in which shareholders were able to purchase up to $15 000 worth of new shares. This fundraising was for the acquisition of ANZ's OnePath Pensions and Investments as well as ANZ Wealth Management businesses.

However, these acquisitions experienced several delays and were not completed until early 2020.

Additional forms of finance

Through **venture capital** an entrepreneur, finance company or superannuation fund can provide finance to a business in exchange for part-ownership. The owners of a new business may have an innovative idea but lack the capital required to act on it. Owing to the high risk, the owners are unable to acquire a loan. They could present their business innovation to a well-established business person, or entrepreneur, who will review their business plan. If the venture capitalist determines that the risk is worthwhile, they will provide the capital for the business to grow and will have minimal involvement in the running of the business.

Grants are financial gifts provided by government to assist businesses to establish or expand. Some businesses may also be eligible for

Venture capital Capital acquired from a specialist venture financial institution that seeks to become a part-owner in the business.

Grants Financial gifts provided by government to assist businesses to establish or expand.

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Activity 10.1
Analysis

Imagine you are a successful business person and one of your social goals is to provide opportunities for young entrepreneurs, who wish to start their own business, by providing venture capital. Identify five characteristics that a venture capitalist would like to see young entrepreneurs display before providing them with finance. One characteristic is provided below as an example.

- An innovative business idea that meets the needs of consumers in a niche market.

Activity 10.2
Comprehension

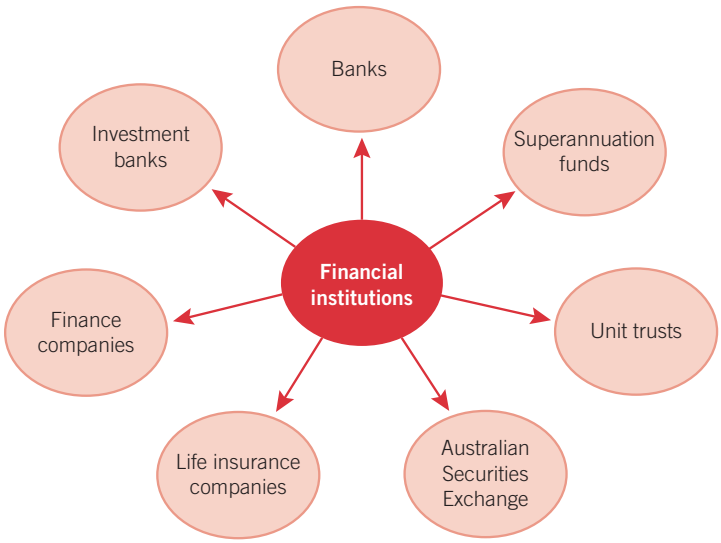
1. Explain why an owner of a private company might be reluctant to acquire additional equity finance from shareholders.
2. Describe the difference between a private company and a public company.
3. Explain the factors an owner would need to consider before sourcing additional finance.
4. Identify the main features of a company that a potential shareholder will wish to consider before investing.
5. Crumpler Pty Ltd has financed its growth using internal sources of finance. Determine the main advantages that this would provide for a business.
6. Research how a leasing agreement works. Identify some reasons that have made this method of financing more common for businesses today.

low-interest government loans. Businesses can use the internet to apply for a variety of grants. To qualify, businesses need to meet strict criteria. Governments believe that certain industries will benefit the economy and therefore should be encouraged by receiving grants. Grants are often available to businesses with export potential.

10.3 Financial institutions

The most obvious place where a business can acquire finance is a bank. However, many restrictions were removed from the financial sector in Australia after December 1983, allowing other financial intermediaries that provide business financial services to enter the market and increase the competition in the financial services market.

These include domestic and foreign banks, investment banks, finance companies, superannuation funds, life insurance companies, unit trusts and the ASX. As a result of globalisation, businesses can also acquire financial services from international financial markets. For example, Australian companies can sell shares on the New York Stock Exchange (Wall Street). This has increased competition in terms of interest rates offered, and also the development of new financial 'products' to sell to businesses. Businesses are able to shop around and find the most suitable debt finance with the best terms for their needs.



Source 10.14 Financial institutions

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Business Bite

There are four independent agencies in Australia that regulate the Australian financial system. They are the:

1. Australian Prudential Regulation Authority (APRA) – deals with the prudential supervision and stability of all intermediaries in the financial system
2. Reserve Bank of Australia (RBA) – deals with **monetary policy**, safety and efficiency of the payments system
3. Australian Securities and Investments Commission (ASIC) – deals with the integrity of the financial market, business conduct and consumer protection in the financial system
4. Australian Government Treasury – develops economic policy.

These entities form the Council of Financial Regulators. The council promotes the stability of the financial system and advises the government on current financial regulations.

The Australian Accounting Standards Board makes accounting standards for private, public and not-for-profit sectors and is aligned with the International Accounting Standards.

Monetary policy Steps taken by the Reserve Bank of Australia to affect the finance market and assist the federal government to achieve its goals of low inflation and economic growth.

EFTPOS Electronic funds transfer at point of sale. EFTPOS allows customers to pay for their purchases electronically using their bank debit or credit card.

BPAY Payment of bills using online (internet) banking.

Unsecured loan A loan that does not require an asset as security. If the loan is not repaid, the creditor who lent the money receives nothing. Unsecured loans have a much higher rate of interest due to the increased risk involved.

Banks

Banks accept deposits from the general public and provide funds for loans. Most large banks have specialist business services that are separate from those available to individual savers or families with home mortgage loans. These are often referred to as authorised deposit-taking institutions and include the Commonwealth Bank, National Australia Bank and St George Bank. Banks provide many financial products for their corporate clients, including:

- online banking, detailed statements, business credit cards and bank overdraft management
- services such as **EFTPOS** and **BPAY**
- business insurance and superannuation funds
- legal and taxation advice
- international trade finance
- risk management
- economic outlook reports.

Investment banks

Medium to large businesses also acquire funds from investment banks such as HSBC, Barclays or Deutsche Bank. These banks are known as merchant banks in the United Kingdom. Investment banks deal with businesses and governments (not individual consumers) by:

- raising large amounts of capital by underwriting share issues
- finding buyers for large bond issues
- setting up a special class of shares
- assisting businesses involved in mergers and takeovers
- providing advice
- arranging nearly any type of finance a business may need
- customising loans to the specific needs of the business.

Finance companies

Finance companies, such as Latitude Financial Services, provide various types of secured and **unsecured loans** to consumers and businesses and usually charge a higher interest rate than banks. Secured loans require an asset (such as property) as security for the loan. If a business or consumer fails to repay a secured loan, the asset will be forfeited to the lending institution.

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Unsecured loans do not require an asset as security and are generally repayable in instalments. Finance companies can arrange commercial bills, **leasing finance** and debentures. Some finance companies also deal in factoring and hire purchase agreements. They do not accept deposits from the general public.

Life insurance companies

The main business of life insurance companies, such as Zurich Australia Limited, is providing insurance against risks such as death and disability through householders investing funds with the company. The participants buy policies, pay regular premiums and are guaranteed a minimum payment at the time of the policyholder's death or in the event of an accident causing disability. Ongoing premium payments provide the life insurance company with funds available for lending to businesses. Generally, interest rates would be higher for loans from these institutions than from banks.

Superannuation funds

Federal government policy and Commonwealth law stipulate that all employees must have a small part of their wage or salary invested in a **superannuation fund**. This superannuation guarantee rate was increased to 9.5 per cent on 1 July 2014 and will gradually increase to 12 per cent by 2025. It is paid into the fund by the employer. By law, these contributions must be made for all employees who work for more than 30 hours per week and who earn more than a gross wage of $450 per month. The purpose of **superannuation** is to provide an investment that people can use as a source of income when they stop working and thereby reduce the need for the age pension provided by the federal government. Over a person's working life, an individual builds up compulsory savings that, when invested wisely, can grow to be a substantial investment. Individuals can also make voluntary contributions of their own. Superannuation funds, such as Hesta, First Super and Australian Super, have very large amounts of money that need to be invested to make a return to pay for the retirement income of the investors in the funds. At the end of September 2020, the superannuation funds totalled $2.9 trillion (APRA). This provides a large source of funds for investment in Australia.

Superannuation funds earn returns by selling debt securities to businesses, the purchase of company shares and government bonds. Since July 2005, individuals have been free to choose their own fund.

Leasing finance Involves a business 'hiring' the assets needed for a period of time, such as a year. The business has the right to use the asset (such as a car, machinery or a building) without having to buy it. A regular fee must be paid, usually monthly, which is an expense for the business.

Superannuation fund All superannuation payments are invested in a superannuation fund. The fund invests the superannuation in, for example, shares or property to earn a return for the employees whose superannuation has been invested with the fund.

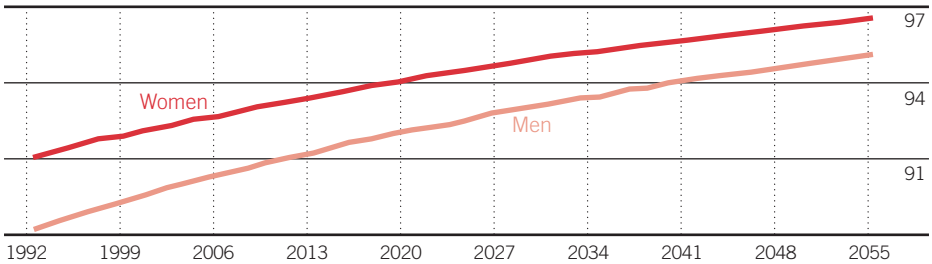
Superannuation Compulsory savings (additional to the employee's wage or salary) paid by the employer and invested in a superannuation fund on behalf of the employee.

Unit trusts

A unit trust (or mutual fund) is formed under a trust deed. A trustee controls and manages the trust. Units are offered to the public for investment.

Source 10.15 Superannuation: funding for future retirement and present-day business growth. Source: Committee for Sustainable Retirement Incomes, Treasury, ABS.

Historical and forecast life expectancy (years)



Quick super facts for 2020

- **$2.7 trn** in assets
- **$9+ trn** in 2040
- Average super balances for 55-64 years:
  - Males **$332 000**
  - Females **$245 100**
- Average age of retirement - 55.4 years
  - Women retire sooner than men
- Retirees with no personal income
  - Women 30%
  - Men 7%

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Activity 10.3
Research and comprehension

1 Research the services that large authorised deposit-taking institutions (ADIs) offer businesses. Using the internet as a starting point, access the website of a large ADI (such as ANZ) and a non-bank financial institution (such as an insurance company) and describe the services they specifically offer to businesses.
2 Outline the differences between personal banks and commercial banks.
3 Discuss the purpose of superannuation funds.
4 Explain why superannuation funds are a participant in financial markets.
5 Explain why some businesses participate in financial markets as providers of finance.
6 Complete research to determine if the Australian superannuation system is having a positive effect on government expenditure levels and support for retirees. Discuss your results with the rest of the class.

Primary market Market in which new shares are floated and sold to the general public for the first time and the company is listed on the exchange.

Secondary market Market in which existing shares and securities are bought and sold by investors without the involvement of the company itself.

All the money from the sale of units is pooled and invested by the trustee. The type of investment is specified in the trust deed. The four main types of unit trusts are property trusts, equity trusts, mortgage trusts and fixed-interest trusts. Unit trusts are increasing in popularity and can be listed on the securities exchange. The trust holds the assets and divides the profits between the individual unit holders. An example is the Sentinel Property Group, which is a property investment firm focusing on the Australian commercial property market.

Australian Securities Exchange

In 1987, six separate stock exchanges – one in each capital city – were amalgamated into the Australian Stock Exchange. In 2006, this organisation merged with the Sydney Futures Exchange to become the Australian Securities Exchange (ASX).

Source 10.16 The Australian Securities Exchange in Sydney

The ASX is a market for buyers and sellers to exchange shares, bonds and other securities. The ASX is a market where, once approved by the ASX, businesses can issue new shares to the general public on the **primary market**; and buyers and sellers can trade existing shares and securities on the **secondary market**.

The ASX is:
- a market operator
- a clearing house where transactions are checked and ownership is transferred to the new owners; the Clearing House Electronic Subregister System (CHESS) keeps a record of share ownership
- a payments system facilitator, by acting as a financial intermediary.

Through its agencies, it monitors and enforces regulations for listed companies and rules for listing new companies.

Listing on the ASX (also known as floating) is a common way for businesses to raise capital. The business must be of a reasonable size and must have continued successful operation for a reasonable time. The business can then issue a product disclosure document, or prospectus. This document gives potential investors a detailed depiction of the business, its finances and the par value of the shares. It must provide an outline of the business's past and predicted future financial performance as well as the risks the business may face. This document must be lodged with ASIC. The issue of shares for

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the first time is referred to as an initial public offering (IPO).

If investor interest is greater than the number of shares available when floated, the offering has been oversubscribed and some potential investors will miss out. The money collected through this process is known as equity finance. The company can use this money to fund expansion, launch a new project, continue growth or for any other business expense.

After the business is floated, investors are able to trade their shares with other investors on the secondary market, where the new price of the shares will be determined through supply and demand.

Review 10.4
Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Identify the major participants in the financial market and – for each – identify one advantage that it can offer a small business.
2. Identify each of the categories of financial institutions in this section of the syllabus.
3. Explain the difference between primary and secondary markets.

Activity 10.4
Research

Research the part played by technology in the financial market, including speed of transactions and transfers, access to accounts, and the number of bank employees. Discuss your findings with other members of the class.

10.4 Influence of government

In Australia, the federal government also influences the financial market and businesses' financial decision-making through its fiscal and monetary policy, government departments and legislation in order to further its economic policy. Two ways that the government influences financial management of a business are through ASIC and company taxation.

Video 10.2 Government influence on the economic cycle

Australian Securities and Investments Commission

The Commonwealth Government set up ASIC under the *Australian Securities and Investments Commission Act 2001* (ASIC Act). ASIC is an independent statutory commission that regulates corporations, markets and the provision of financial services covered under the *Corporations Act 2001* (Cth). The Corporations Act contains provisions for consumer protection, the supervision of financial market operations (for example, the ASX), insurance, superannuation, life insurance, retirement savings and medical indemnity. ASIC tries to ensure honest, efficient and fair provision of financial services.

ASIC works to reduce fraud and eliminate unfair practices in the financial market. It performs market assessments of businesses, and raises questions about business reports and activities such as insider trading. ASIC also identifies areas of improvement to meet corporate requirements. Any misconduct is made available to the public through the media, providing negative publicity for the business (possibly ASIC's strongest weapon against corporate wrongdoing and crime). Financial penalties and imprisonment may also be imposed for serious breaches of the law. (Examples of reports can be found on the ASIC website.)

Company taxation

For 2020, company tax is currently a flat rate of 27.5 per cent on net profit for small businesses (that is, those with less than $50 million turnover in the financial year) and is being progressively lowered to 25 per cent for the 2021–22 financial year.

Larger businesses (that is, those with more than $50 million turnover) are subject to 30 per cent tax. This has gradually decreased from 36 per cent in 2000 with the aim of encouraging investment in Australian business and assisting economic growth. Several countries currently impose higher rates of company taxation, such as France (34.5 per cent) and Malta (35 per cent). Other countries have lower rates, such as the United Kingdom (19 per cent), Thailand (20 per cent) and Sweden (22 per cent), and

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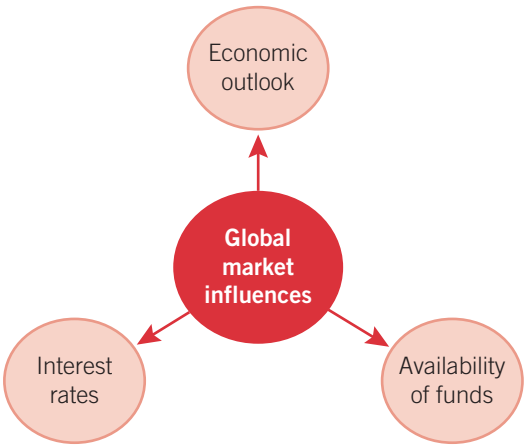
Digital quiz
Please see the Interactive Textbook to access digital activities.

many have decreased their corporate tax rates to encourage economic growth and job growth. In Australia, in the case of financial institutions, various taxation rates apply. Superannuation funds and retirement savings accounts pay 15 per cent tax. This lower rate of taxation is an incentive program by the government to encourage people to save for retirement.

10.5 Global market influences

Overseas influences have increasingly affected the Australian financial market due to globalisation and increased interdependence between economies and foreign markets.



Source 10.17 Global market influences

Global market influences are from the external business environment and beyond the direct control of individual businesses. These influences may present businesses with opportunities as well as threats. To reduce risks and minimise losses from threats, financial managers must be aware of influences on the Australian financial market from within Australia and from overseas and develop strategies to cope with these issues. Three major areas of influence are economic outlook, interest rates and the availability of funds.

Economic outlook

Economic outlook refers to the expected levels of economic growth of individual nations throughout the world. Economies go through cycles of increasing growth and times when the economy slows down. Due to globalisation and the increased nature of interrelated global actions by individuals, businesses and governments, nations have become far more dependent on each other for resources and incomes. Following the Global Financial Crisis (GFC) of 2008–09, many advanced economies pushed forward and achieved slow and continued growth. However, this was interrupted by international shocks in both positive and negative ways. Prior to 2019, such factors included:

- the push for reusable energy and away from fossil fuels
- the slowdown of one economy that has significant trade with other nations
- the changing trends for nations to move away from manufacturing and towards consumption and services, such as China
- the swine flu epidemic
- earthquakes, tsunamis and other natural disasters
- political shocks and the uncertainty caused by actions such as the 2016 Brexit referendum and the United Kingdom's withdrawal from the European Union (EU)
- the slowdown of projected growth of emerging and developing economies such as Bangladesh and Pakistan
- the previously steady recovery of the United States
- increased international monetary controls.

However, for the Australian economy, this growth was further interrupted by severe drought on a national scale and bushfires during 2019–20. Additionally, the COVID-19 pandemic spread across the world and resulted in a global recession in 2020.

The concept of globalisation and its advantages for trading economies have been called into question. Prior to 2018, global growth was estimated at 2 per cent. By June 2020, the International Monetary Fund (IMF) estimated that global growth had fallen to –4.9 per cent and created great uncertainty in the international marketplace. Over 95 per cent of countries were projected to have negative growth in 2020, with export-dependent economies more severely affected, and trade decreasing by at least 12 per cent globally.

This downturn has had serious effects on the Australian economy, further weakening demand for Australian products. The Australian economy had already suffered decreased production, especially in regional areas due to

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the drought and bushfires. This has been further affected by the coronavirus as the government enforced lockdowns, social distancing and workplace restrictions. Consumer and business confidence fell to a new low not seen since the Depression of the 1930s, as businesses closed, industrial production and the tourism and hospitality industries contracted. As a result, the financial market has tightened, even though the Australian dollar has regained some strength. Unfortunately, this also results in higher prices for our exports and decreased demand as we become less competitive and overall demand worldwide falls.

As businesses make financial decisions based on their expectations of the future, governments worldwide have provided significant funds through stimulus packages to workers and businesses. Globally, up to June 2020, this has been estimated to be $10 trillion.

Interest rates

As part of managing proactively, financial managers will be concerned with changes in the future cost of finance (that is, the rate of interest charged). There will also be variation in interest rates between countries. In the past, interest rates were often lower in overseas markets and businesses would raise finance overseas. However, adverse currency movements could eliminate this advantage of lower interest rates. The pandemic and subsequent uncertainty in the market have caused interest rates worldwide to decrease substantially. In Australia, the RBA has maintained low levels of interest rates to encourage the private sector to invest as well as to provide relief for existing borrowers.

Although this low rate would be an advantage for business, the lack of consumer confidence and changes in the buying patterns of consumers, as well as general market uncertainty, have resulted in only a few entrepreneurial decisions being made.

Availability of funds

If Australia is seen as providing a safer and higher return for investors than Japan or China, money will flow into Australia. Based on the interaction of supply and demand, this will reduce local interest rates as more funds become available, making it cheaper for businesses to borrow domestically. Generally, fund availability and risk are reflected in the interest rate charged. The larger the risk, the higher the interest rate. However, international shocks will continue to cause uncertainty in the market, resulting in higher risk levels.

Currently, the IMF is trying to ensure that funds are available to governments to support their economies. Governments are working to stabilise their economies and provide support and incentives for private sector business to promote future growth.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 10.18 Global financial downturn due to COVID-19

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Chapter summary

Financial management involves planning, organising, monitoring and controlling the monetary resources of a business in a way that will fulfil its financial objectives and enable the business to achieve its strategic goals.

A business can source money from inside the business (internal finance) or outside the business (external finance).

Internal sources of funds are called equity. These sources of funds include capital contributed by owners through shares or invested funds when the business began, reinvested profits and the sale of an unwanted business asset.

External sources of finance include debt finance, which is borrowed money, and equity in public and private companies.

Types of debt finance can be short-term or long-term. Short-term types include bank overdrafts, commercial bills and factoring. Long-term finance includes mortgage loans, debentures, unsecured notes and leasing.

Factoring enables a business to increase its cash to finance the payment of short-term liabilities and expenses. Accounts receivable is sold to a factoring firm for cash at a discounted price.

Unsecured notes do not have security, are riskier and carry a higher interest rate.

Leasing allows a business to finance an asset by effectively hiring it for a fixed period of time.

Private equity refers to selling shares by inviting specific people to become part-owners of the business in a private company.

Public companies issue securities or shares to the general public through the ASX.

External equity involves the issue of new shares for public companies, rights issues to existing shareholders, placements to specific institutions and specific investors, and share purchase plans to existing shareholders.

Many different types of financial intermediaries operate in and influence Australia's financial markets, including:

- traditional banks, which have moved into the market for business financial services as well as services for personal depositors
- investment banks, which deal mainly with large businesses and large amounts of capital, have developed financial products and become more competitive
- other intermediaries such as finance companies, life insurance companies and superannuation funds, unit trusts and the ASX.

The ASX is a market that allows companies to issue shares on the primary market to raise equity finance. It also facilitates the buying and selling of existing shares on the secondary market.

The federal government:

- influences interest rates by buying and selling securities and offering financial grants
- established ASIC to oversee the operations of financial institutions
- gains funds through taxation on company profits
- uses monetary policy through the RBA to adjust interest rates to drive the economy and make the cost of borrowing cheaper or more expensive.

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Globalisation has resulted in finance flowing into Australia when interest rates are higher than in countries overseas or flowing out when they are lower. Businesses can acquire finance from overseas stock exchanges and overseas financial institutions.

Key areas of overseas influence include global economic outlook, world interest rates and the availability of international funds.

End-of-chapter tasks

Chapter revision tasks

1 Rewrite the following paragraphs using the words listed in the box to fill in the blanks.

capital	owner	float	primary
Securities	secondary	shares	additional
investor	ASIC	prospectus	public

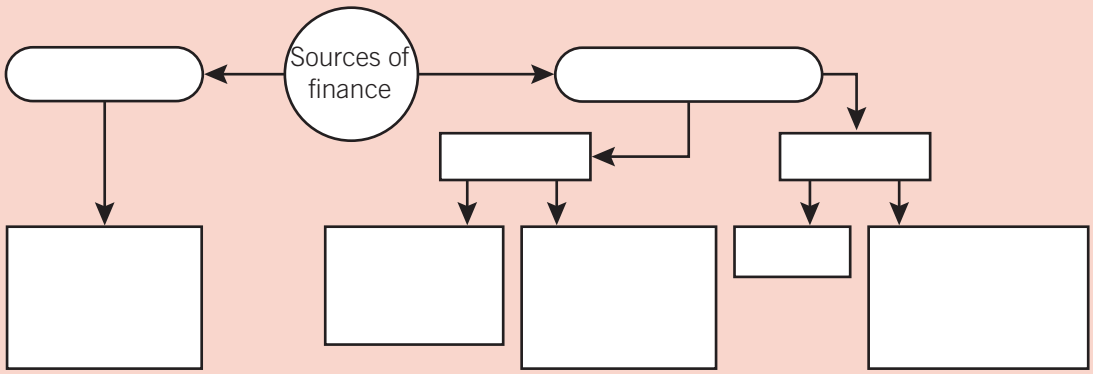
A business wishing to _____ on the Australian _____ Exchange must submit its prospectus to the ASX and _____. Having satisfied the conditions of these regulators, the issuing company offers a fixed number of _____ at a stated price to the general _____. The _____ provides a potential _____ with company information such as directors and proposed business activities. This initial public offering is done on the _____ market to raise _____ for the public company. Firms that are already trading can raise _____ capital through new share issues.

Existing shares can be resold on the _____ market. In the secondary market, when shares are resold ownership of the shares changes and the previous _____ receives the money.

2 Recall what the following acronyms stand for:

ACCC, ASX, ASIC, RBA, Ltd, Pty Ltd, GFC, EFTPOS, ADI, APRA

3 This diagram shows the various sources of finance available to a business. Using the terms from the Business Studies syllabus (on the NSW Education Standards Authority website), copy and complete the mind map.



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Multiple-choice questions

1 Which of the following are external sources of finance available to a business?

A Shares, retained profit and loans
B Leasing, factoring and venture capital
C Retained profit, start-up capital and the sale of unwanted business assets
D Commercial bills, shares and retained profits

2 Which of the following statements about the Australian Securities Exchange (ASX) is true?

A The ASX is a primary market.
B The ASX is a secondary market.
C The ASX is both a primary and a secondary market.
D The ASX is neither a primary nor a secondary market.

3 Which of the following is a short-term source of debt funding?

A Debentures
B Retained and undistributed profits
C Overdrafts
D Mortgages

4 Hot Power Ltd needs to raise $5 million to invest in a new production line for its manufacturing plant. The business has sent a proposal to its existing shareholders offering them the opportunity to purchase additional shares.

What type of financing is this?

A Rights issue
B Placement
C Debenture
D A float

5 What is the advantage of a bank overdraft for a business?

A Interest rates are usually lower and more variable than mortgage loans.
B Interest rates are usually higher and unlimited finance is available at very short notice.
C Finance is available at short notice and is preapproved.
D Interest rates are fixed and repayment can be delayed.

6 What is an advantage of raising capital through a placement?

A You buy back the shares.
B The shareholders have to approve it.
C You don't have to have a prospectus.
D You can raise as much as you want.

7 PRT Pty Ltd is sourcing finance to purchase stock from Singapore. Which source of finance would be most appropriate to suit its needs?

A Debenture
B Leasing
C Credit card
D Commercial bill

8 Which regulatory body is responsible for ensuring that laws related to financial institutions are complied with?

A Australian Securities Exchange
B Australian Securities and Investments Commission
C Australian Prudential and Regulatory Authority
D Reserve Bank of Australia

9 Fred & Jane's gelato bar uses an overdraft to supplement its cash flow in the winter season. An overdraft is:

A available through their trading account facility.
B part of their equity financing.
C provided through their insurance company.
D a long-term solution to their problem.

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10 What source of funds is most appropriate for purchasing stock in a small shop or restaurant?

A Factoring and leasing
B Mortgage and bank overdraft
C Bank overdraft and trade credit
D Trade credit and debentures

Short-answer questions

1 Describe the process a company must follow in order to raise equity finance through the Australian Securities Exchange.

2 Outline the role played by regulatory authorities in the financial system in Australia.

Extended-response question

Since reading that Australia exports more than 32 000 tonnes of tripe to Hong Kong, The Great Aussie Meat Pie Company has developed a tripe pie for export to the Asian market. The company wishes to find out more information about funding research and marketing the new pie and what it needs to do financially to begin exporting.

Synthesise a business report describing the sources of finance available and recommend those that The Great Aussie Meat Pie Company should use.

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11 Processes of financial management

Chapter objectives

In this chapter, students will:

- identify the processes involved in financial management
- explain monitoring and controlling
- use financial ratios to analyse financial information
- investigate the limitations of financial reports
- analyse ethical issues related to financial management.

Key terms

- accounts receivable turnover ratio
- audit
- balance sheet
- capitalised expenses
- cash flow statement
- credit policy
- current ratio
- depreciation
- gearing: debt to equity ratio
- goodwill
- gross profit ratio (GPR)
- income statement
- insolvency
- intangible asset
- matching principle
- net profit ratio (NPR)
- normalised earnings
- opportunities
- return on equity (ROE) ratio
- secured creditor
- threats
- trademark
- triple bottom line (TBL)
- warranty

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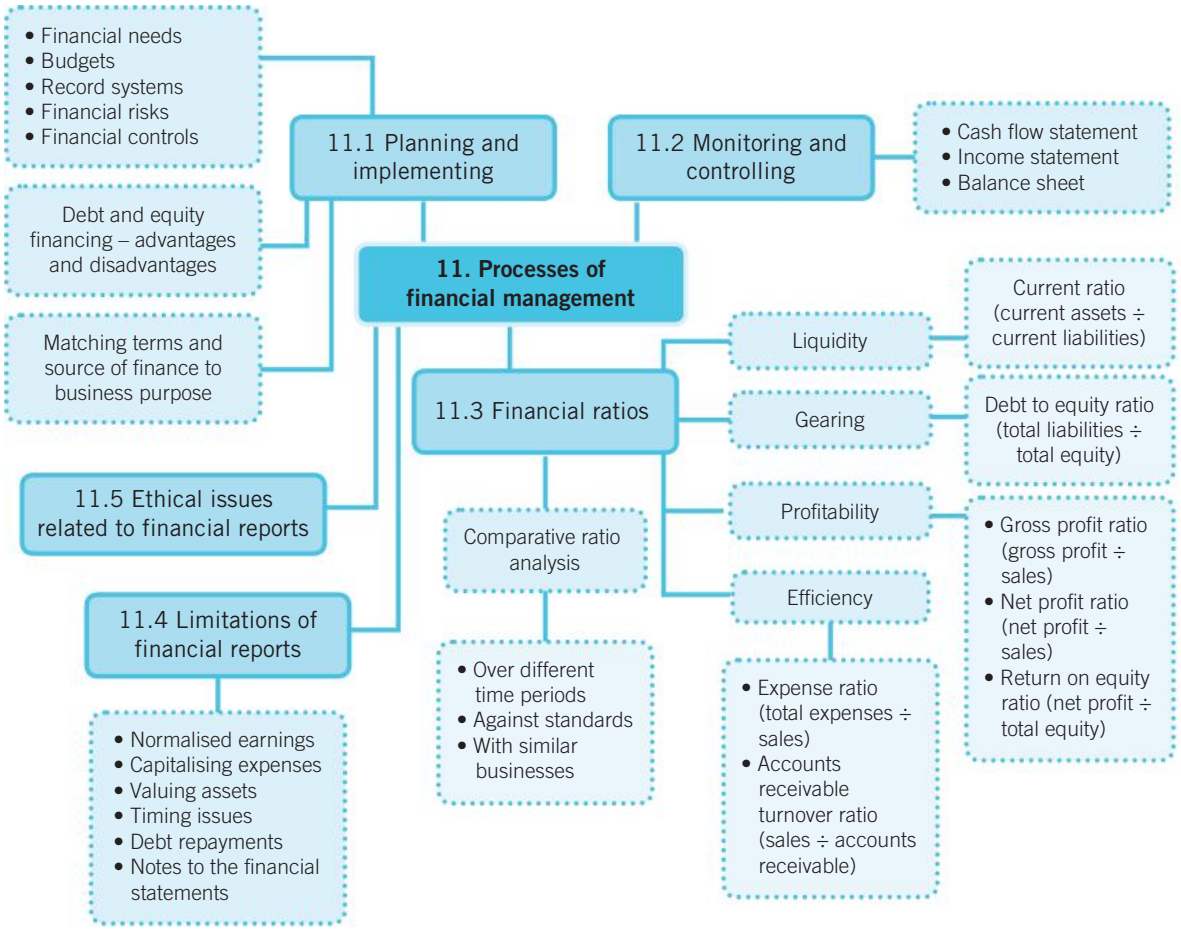
11.0 Introduction



Source 11.1 Processes of financial management concept map

Digital quiz
Please see the Interactive Textbook to access digital activities.

11.1 Planning and implementing

Financial management involves planning, sourcing and controlling the business's finances for each department to be able to achieve its objectives. Financial managers must make projections for profitability and financial stability. The financial statements that back up the business plan will show whether the plan for a product will generate sufficient cash flow to be successful, cover expenses, meet debt obligations and provide a return for investors in the business.

In order to do this, financial managers must:

- determine financial needs
- set budgets
- instigate record systems
- determine financial risks
- develop financial controls.

Source 11.2 Planning and implementing financial management

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Financial needs

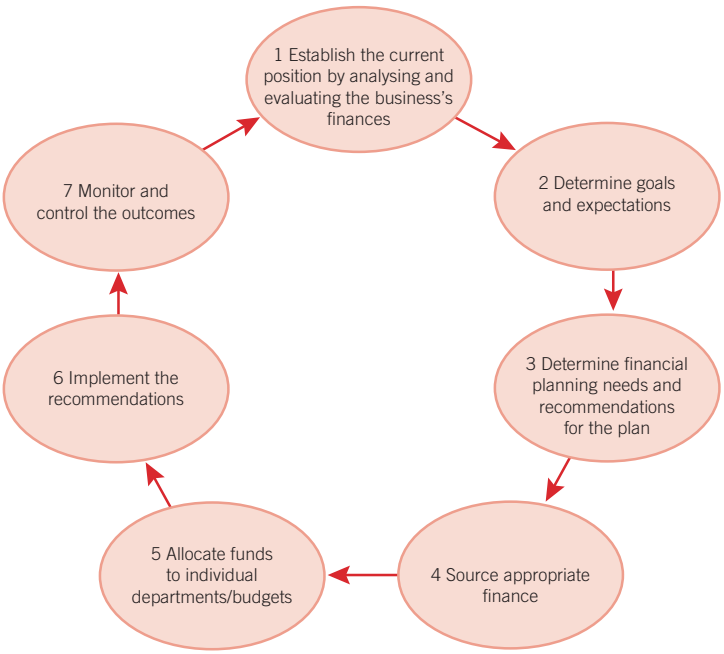
A new business will have to determine its start-up costs. These will include such things as the purchase of new equipment, obtaining appropriate premises, inventory, staff, marketing and utilities, as well as paying legal fees and other service providers.

Opportunities Changes in a firm's external environment that may present a benefit for the firm or present the firm with an opportunity for improvement or expansion.

Threats Changes in a firm's external environment that may present problems for the firm.

Once a business has begun operations, additional funds will need to be available when necessary, or else liquidity problems will develop. Cash flow shortages present major problems for a business.

The business will need to make financial forecasts based on information gained from market and product research. Managers will also consider the external environment, such as competitors and the economy. Situational analysis will establish the business's present position in the market. It will help determine its future direction and the strategies used to achieve the business goals – all of which will be dependent on the finance available.



Source 11.3 Determining financial needs

Budgets

A budget is a plan for achieving set outcomes and is based on forecasted figures and expectations of future operations. This plan could be for six months, 12 months or longer. In most businesses, planning includes individual departments being presented with a budget to work with.

Department managers need to determine the resources required and identify future **opportunities** and **threats** in order to set realistic objectives.

A budget provides details, in money terms or units, about what the business wants to achieve and creates a framework for internal decision-making (for example, predictions for sales revenue and expenses). It establishes standards and can be used as a planning and control tool. Budgets allow comparisons between actual results and the initial plan and an evaluation of business progress. This may lead to adjustments being made to parts of the plan or to changes in individual departments to bring them in line with the rest of the business.

Source 11.4 Businesses can use past performance records to predict future budgeting needs.

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An existing business has the benefit of its historical records and an understanding of the business's culture and how the business operates, and can therefore base its predictions on past performance and the external environment in which it operates.

Budgets may be divided into several categories, the main ones being operating budgets and financial budgets.

An operating budget provides detailed estimates of the revenue and expenses based on forecasted sales revenue generated from the main activity of the business. This is a short-term budget; large capital outlays are not included. This information may be used to produce a budgeted **income statement** and to plan necessary inventory levels, labour requirements or the quantity and quality of raw materials needed for production. Such information relates more to the day-to-day activities of the business.

A financial budget uses the information from an operating budget and presents a forecast of funds required to pay for these inputs and the anticipated inflow of funds from future sales. This can be shown as a budgeted cash flow statement and should highlight periods of cash shortage, the need for short-term finance (such as an overdraft) and periods of cash surplus. Firms may also use a financial budget to plan for future capital expenditure (such as a new project) to ensure that funds will be available when necessary. Financial budgets also include forecasted income statements and forecasted balance sheets.

Record systems

Businesses need to set up record systems to record data needed by the business, such as client accounts, employees' wages, accounts payable (for example, suppliers) and taxes.

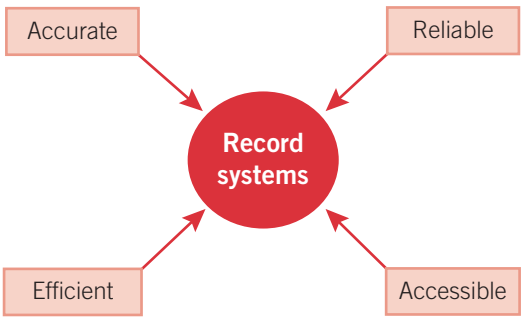
Today, many businesses use electronic record-keeping systems such as MYOB, which can generate orders, invoices, financial statements, employee pay records and inventory details. These are still dependent on the accuracy of the data entered into the system. Hard copies of transactions such as invoices still need to be kept and filed efficiently so they can be accessed when required. In each case, financial managers must ensure that they meet accounting standards and can provide accurate and reliable financial reports.

Accounting records of expenses and revenues must be kept by law, and a company's annual financial report is presented to shareholders, the Australian Taxation Office (ATO) and the Australian Securities and Investments Commission (ASIC). Internally, the business needs to have records available for future planning and control procedures to ensure that goals are achieved.

Income statement A summary of a business's revenue and expenses over a set financial period. It is completed in order to determine the business's profitability and efficiency. Also known as a revenue statement or profit and loss statement.

Records management receives, stores and retrieves relevant information. Some information may be confidential due to privacy laws, or contain industry secrets, and a security system should be in place to control individuals' access to information. Record systems also prevent fraud and theft by employees.

Management information systems (MIS) are often developed by larger businesses to allow managers to access organised units of information appropriate to their needs. The human resource department would need to have access to employees' work history, skills, qualifications and often data of a personal and private nature.



Source 11.5 Record systems are set up to record data needed by the business.

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Business Bite

MYOB (Mind Your Own Business) is an Australian company offering a complete accounting software package. The product was launched in 1991, with the aim of providing accounting software for non-accountants. This was followed in 1993 with packages for accounting professionals who were supporting business owners. The original Windows software was standalone, but in 2013 MYOB joined with BankLink to offer a cloud-based solution, including iPhone and Android apps.

MYOB is the market leader for online accounting and payroll in Australasia. As of November 2018, it was the fastest-growing cloud-based accounting software business in Australia and New Zealand. Innovation through the MYOB adviser using artificial intelligence and natural language generation enables client-to-accountant conversational communication. MYOB is especially successful in the small to medium-sized business area.

In 2020, MYOB teamed up with Mastercard and Visa to allow businesses to process payments for bills, invoices and staff payroll as well as access to loyalty programs for credit card payments, through their MYOB software package. MYOB has expanded beyond simply accounting and bookkeeping packages to include employee management, such as incorporating rostering, hours worked and timesheets.

Source 11.6 A company's annual financial report must be presented to shareholders.

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Financial risks

Financial managers need to assess the financial risks that a business faces each day. These may include theft of stock, fraud, non-payment of accounts receivable or possible interest rate increases. These issues could result in liquidity problems in the short term, and ultimately in long-term solvency issues where the business has difficulty paying its bills and loan repayments, and generally suffers financial pressure. This would also affect the day-to-day running of the business.

Businesses should be proactive and ensure they are fully aware of future threats to their business by undertaking continuous research of the business environment. They need to analyse the profitability of alternative decisions and the financial risk for their owners. Profits need to be able to cover the cost of the debt as well as justify the risk involved. Increased taxes could increase costs, decrease sales due to increased price and cut profit levels if the price cannot be increased by the full level of the tax.

Financial controls

Financial managers will need to put in place several financial controls that can be used to establish whether the business is achieving its objectives. Controls need to be put in place to prevent theft of stock or even fraudulent use of funds, such as through employees' expense accounts and business credit cards. These controls could include payments requiring receipts, two people signing cheques, regular reporting of expenses and the clear division of work duties. Budgets can be used to indicate the difference between the original plan and what was actually achieved.

Managers can then determine if their objectives need to be reassessed, if the strategy was not successful or if planning was based on unrealistic assumptions.

Source 11.7 Financial managers ensure that financial controls are in place and are effective.

Debt and equity financing

Debt finance is made up of borrowed funds. It involves a contractual agreement based on specific conditions over a period of time. The borrower will need to repay the principal (the initial amount borrowed) as well as pay interest. Most debt finance usually incurs administration fees and government charges such as stamp duty.

Video 11.1 Differences between debt and equity financing

Equity financing is money lent to the business in exchange for ownership in that business. This includes start-up capital and additional capital raised through share issues. Highly geared businesses carry greater risk, as they have significant debt compared to equity, and they may run into liquidity and solvency problems making loan repayments.

Newly established businesses will not have the past history to obtain a sizeable loan. They will need a well thought-out business plan, a good business idea and some start-up capital to attract additional investors. For existing businesses, a good reputation and credit history make it easier to obtain loans.

Business Bite

Michael Issakidis and Anthony Dickson were directors of Neumedix Health Australasia Pty Ltd. They masterminded a corporate tax scam (tax evasion scheme) that made them more than $63 million. In 2015, Anthony Dickson was sentenced to 11 years' jail, later increased to 14 years on appeal. In March 2018, Issakidis was sentenced to 10 years' jail in the Supreme Court of New South Wales for the part he played in a $135 million tax fraud and money laundering activity. He and Dickson had inflated the values of medical technologies from a Cayman Islands company and claimed massive tax deductions based on the depreciation of their value over time.

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Source 11.8 Advantages and disadvantages of debt finance

Advantages of debt finance	Interest payments are tax-deductible business expenses.
	Increased funds can result in increased sales and profits.
	It can be relatively simple to acquire.
	Loan terms can be negotiated to meet the business's specific needs.
	Debt repayments can be easy to plan for, as these are normally scheduled, regular payments of interest and often principal.
	It will not decrease your ownership in the business.
Disadvantages of debt finance	Debt can be expensive (based on interest rates and charges).
	Repayments begin immediately and must be met regardless of the business cash flow.
	Collateral is often needed to secure a loan.
	In some cases, personal guarantees may be needed.
	You may require a good credit history for borrowing.
	It is up to the owner of the business to clearly establish the value of the business and its ability to repay the loan.
	If bankruptcy or insolvency occurs, debt providers have priority before equity providers; **secured creditors** are paid first.

Secured creditor A bank, financial institution, supplier or individual that is owed money by a business and holds security over an asset the business owns in case the loan is not repaid.

Source 11.9 Advantages and disadvantages of equity finance

Advantages of equity finance	It does not have to be paid back.
	There are no repayments; therefore the firm has more cash available.
	Cash flow generated (especially from additional share issues) can be used for further investment and expansion.
	It does not incur interest charges.
	Investors may be prepared to wait for some time to get a return on their investment.
	There is less risk for the business.
Disadvantages of equity finance	You are exchanging ownership of your business.
	A proportion of the profits goes to the additional new owners.
	It does not provide a tax deduction for the business.
	New investors often expect improved growth and performance of the business and ultimately a better return on their investment.
	Equity partners might demand to have a seat on the board or otherwise being involved in running the business.

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Matching the terms and source of finance to business purpose

When managing finance, the accountant will distinguish between short-term and long-term debt finance. This is important because short-term finance will need to be paid back sooner and usually costs more than long-term finance. However, there is usually greater convenience with short-term finance. For instance, a credit card gives instant access to funds, while a mortgage loan can take weeks to organise.

The main reason for identifying the options for short-term and long-term debt finance is to match the term of the loan with the economic lifetime of the asset purchased. This is referred to as the **matching principle**. A short-term or current asset needs to be matched with short-term finance (for example, inventory financed with trade credit or an overdraft). Non-current assets should be purchased with long-term finance (for example, premises with a 15-year mortgage). This concept applies to both debt and equity financing.

General factors may include:

- The legal structure of the business. Companies can generally carry a higher level of debt to equity, while unincorporated enterprises will carry lower levels of debt to equity. This reflects the potential for personal bankruptcy for the owners, owing to unlimited liability if a sole trader or partnership fails.
- More profitable firms are more likely to increase debt than increase equity because they can afford the interest expense with less risk.
- Companies with increased share prices due to growth opportunities are more likely to issue equity.
- When interest rates are low, debt finance is more attractive.
- Forward planning can allow a business to build up retained profits for future asset purchases.
- A business's credit rating, if low, can make it difficult to obtain a loan or have higher interest charged, thus making equity a more viable option.

In each case, the source and cost of the funds need to be matched with the use of the funds and the expected return from those assets.

Matching principle Involves using the appropriate finance for purchasing an asset. Current assets should be purchased with short-term finance, while non-current assets are purchased with long-term finance. The term of the loan should be matched to the economic life of the new asset.

Source 11.10 Non-current assets, such as land, should be purchased with long-term finance.

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Source 11.11 Comparison of short-term and long-term debt finance

Type of debt	Length of loan
Short-term debt (less than 12 months)	
Bank overdraft	Indefinite, but the business must make minimum monthly payments; rolled over each month, interest charged on the daily balance
Credit card	Indefinite, but the business must make minimum monthly payments; rolled over each month, interest charged on the unpaid monthly balance
Trade credit	Generally a minimum of seven days; maximum of 90 days
Commercial bills	Average of 90 days, but can be rolled over for additional months
Long-term debt (greater than 12 months)	
Term loan	Fixed number of years
Debentures	Number of years set by the issuing company
Mortgage loan	Commercial real estate mortgage up to 20 years (individuals up to 35 years)

Review 11.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Explain the differences between debt finance and equity finance.
2. Describe the advantages and disadvantages of equity finance over debt finance.
3. Discuss why an owner of a new company may be reluctant to acquire additional equity finance from shareholders.
4. Outline three features of a company that a potential shareholder should consider before investing.
5. Identify factors that will influence an owner's choice of finance to expand the business.

11.2 Monitoring and controlling

Accounting information is used by managers to monitor and control the business's functions. The general purpose of financial reports is to communicate relevant, reliable and understandable information about the business that can be used by managers to make decisions. They need to be able to trust that the figures and calculations are correct. Data can be used to make forecasts (such as projected sales) and to evaluate the business's performance by comparing the current year's sales to the previous year's sales.

Insolvency Occurs when expenditure has exceeded income for an unacceptable length of time and the firm is unable to pay its debts.

There are three types of financial statements used for monitoring and controlling (see Source 11.13). Improved technology allows accounting statements to be produced on computers using inexpensive, easy-to-use software. By entering all primary transactions (such as sale dockets and receipts), the software can summarise the data and produce accurate statements on request.

Cash flow statement

One of the biggest problems that businesses face today is their ability to control their cash flow (that is, to maintain their liquidity). Firms need to be able to pay their debts as they fall due or they run into liquidity problems in the short term and insolvency in the long term. **Insolvency** occurs when expenditure has exceeded income for an unacceptable length of time. The firm is unable to pay its bills and loan repayments, and this could lead to the closure of the business.

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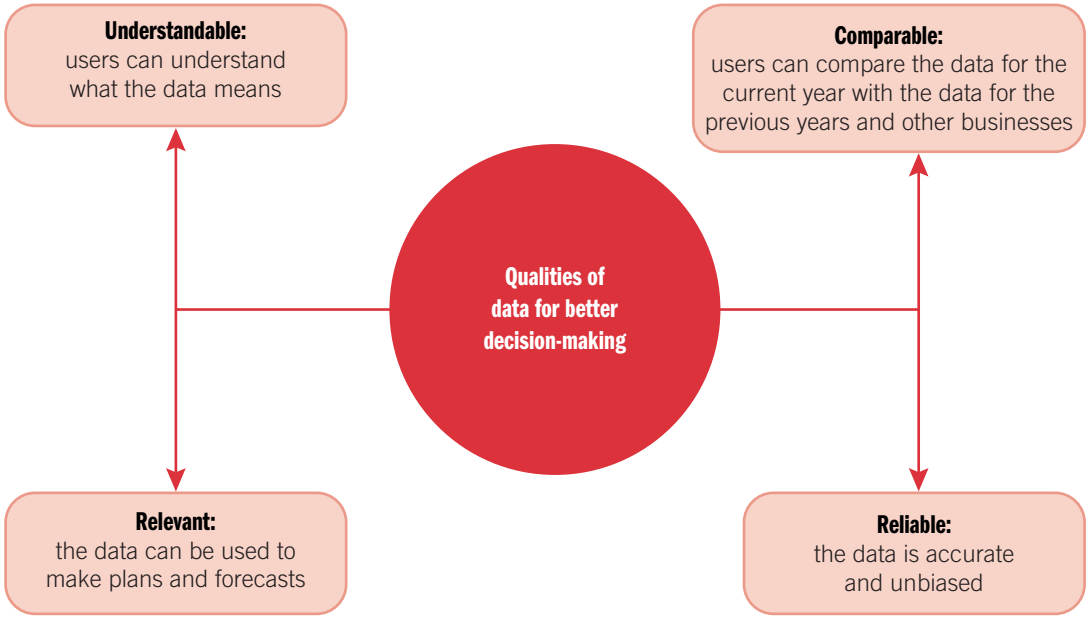
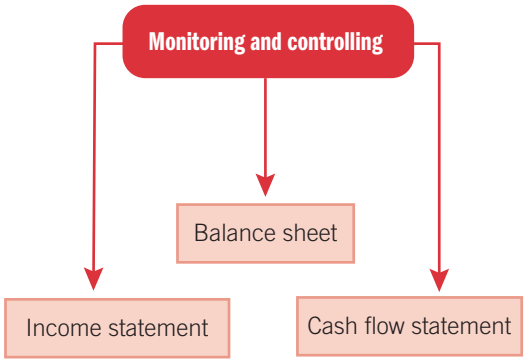


Source 11.12 Data needs to have certain qualities to facilitate better decision-making.

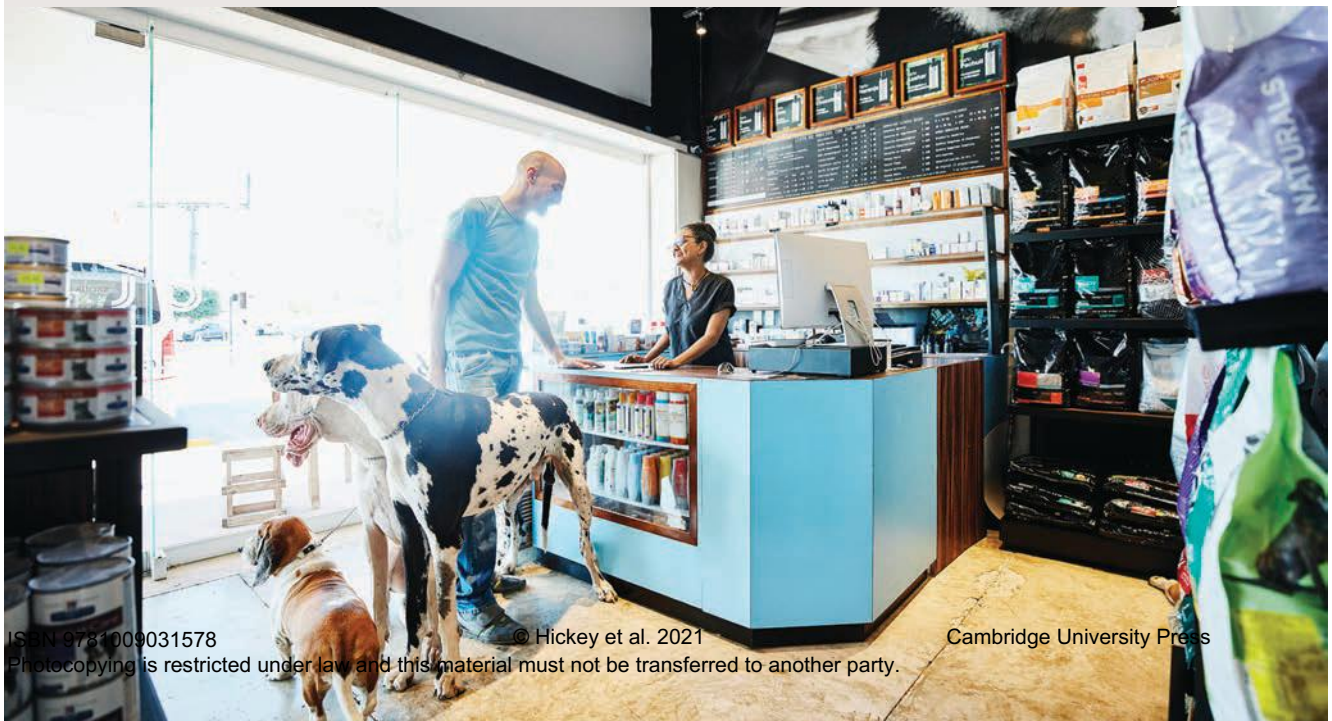


Source 11.13 Financial statements used for monitoring and controlling

A **cash flow statement** (or funds statement) summarises cash transactions that have occurred over a period of time. Its purpose is to provide information about the flow of cash receipts and cash payments within the accounting period and provide management with necessary details for budgeting, identifying periods of cash shortage and surplus. This enables the business to monitor and control its spending.

Cash flow statement A financial report illustrating the movement of cash into and out of a business over time.

Source 11.14 Cash transactions are summarised in a cash flow statement.



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Type of financial statement

Cash flow statement for Happy Pet Products Pty Ltd for the quarter ending 31 December 2021

Business name

	October	November	December
	$	$	$
Opening cash balances	11 000	15 000	26 750
Cash inflows			
Cash sales receipts	20 000	35 000	47 000
Interest received	1 000	1 000	1 000
Total inflows	21 000	36 000	48 000
Cash outflows			
Suppliers	10 000	17 000	22 000
Wages	2 000	2 000	3 000
Rent	1 500	1 500	1 500
Advertising	3 000	3 000	5 000
Other expenses	500	750	1 250
Total outflows	17 000	24 250	32 750
Closing balance	**15 000**	**26 750**	**42 000**

Balance in account at the beginning of each month

Cash flowing into the business during each month

Cash flowing out of the business during each month

Cash balance at the end of the month. This is also the value of the opening balance for the next month

Source 11.15 Cash flow statement for Happy Pet Products Pty Ltd

Activity 11.1
Cash flow statement

Cash flow statement for Hazy Ski Hire Pty Ltd for the six months ending 31 December 2021

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
	$	$	$	$	$	$
Opening cash balance	350	6 100	2 650	8 500	(4 600)	(2 600)
Inflows						
Sales receipts	12 400	11 200	10 100	9 500	9 600	7 800
Interest	300	300	300	200	200	100
Dividends	–	–	2 400	–	–	–
Total cash inflows	12 700	11 500	12 800	9 700	9 800	7 900

Continued →

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Activity 11.1 *continued*

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
Outflows						
Wages	2400	2400	2400	3100	3100	3100
Rent	4000	4000	4000	4000	4000	3000
Insurance	–	8000	–	–	–	–
Electricity	400	400	400	400	400	400
Telephone	150	150	150	300	300	300
Asset purchase	–	–	–	15000	–	–
Total cash outflows	6950	14950	6950	22800	7800	6800
Closing cash balance	**6100**	**2650**	**8500**	**(4600)**	**(2600)**	**(1500)**

Complete the following questions using the information provided in the cash flow statement for Hazy Ski Hire Pty Ltd that follows.

1. Identify the balance in the business's bank at the beginning of the cash flow statement period.
2. Identify how much cash flowed into the business in the first month.
3. Describe the main reason the business went into negative bank balances.
4. In which month would this business need to have an overdraft facility in place?
5. Identify how much cash the business had in its account at the end of the cash flow statement period.
6. Identify the month in which the business had the lowest level of cash inflow.
7. Identify the month in which the business had the highest level of cash outflow.
8. Describe some possible changes in cash outflow that the business could have organised to solve its cash flow problems and ensure that its account did not go into a negative balance.
9. Give one possible explanation as to why its cash sales receipts have decreased over this time period.

Income statement

The income statement summarises the income and expenses of a business over a specific accounting period, such as a financial year. It helps the financial manager determine if the business is reaching its financial objectives.

It shows the relationship between revenue and expenses to calculate net profit and therefore indicates the business's profitability and efficiency. This financial report is also known as a profit and loss statement, or revenue statement, as it shows total revenue received, gross profit, the cost of goods sold, expenses and net profit. The income statement is usually produced at the end of the financial year (on 30 June) and will show the net profit earned over a specified period of time. A financial manager can produce this report at any time to monitor the progress of the financial and business plan over the course of each week or month. The manager can also establish trends and make comparisons.

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Type of financial statement

Income statement for Happy Pet Products Pty Ltd for year ending 30 June 2021

The trading period covered by this report

Sales			630 000
less Cost of goods sold			
Opening stock	120 000		
plus Purchases	210 000		
minus Closing stock	80 000		250 000
Gross profit			380 000
***less* Operating expenses**			
Selling administration expenses			
Advertising	38 000		
Cartage outwards	1 000	39 000	
General expenses			
Wages	25 000		
Phone	4 800		
Lease payments	18 000		
Electricity	6 000	53 800	
Financial expenses			
Interest paid	18 000		
Discounts allowed	1 000	19 000	111 800
Net profit			**268 200**

Inventory the business has at the beginning of the accounting period, i.e. at 1 July 2020

Total value of the goods sold by the business in the financial year

Business name

Expenses incurred through the operations of the business. These are additional to the inventory

Additional stock bought throughout the financial period

Inventory (stock) the business still has at the end of the accounting period, i.e. on 30 June 2021

The final result of business operations, i.e. total revenue less cost of goods sold (COGS) and less all other expenses. Tax is levied on this amount

Sales revenue less cost of goods sold

Source 11.16 Income statement for Happy Pet Products Pty Ltd

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Activity 11.2
Income statement

Income statement for CDE Pty Ltd for the years ending 30 June 2020 and 2021

	2020		2021	
	$	$	$	$
Revenue				
Sales – Goods	229200		226366	
– Services	9550		7250	
Total sales revenue		**238750**		**233616**
***less* Cost of goods sold**				
Opening stock	85450		56106	
plus Purchases	60212		53664	
	145662		109770	
less Closing stock	56106	89556	58104	51666
Gross profit		**149194**		**181950**
***less* Operating expenses**				
Selling	48016		44125	
Administration	75861		67599	
Financial	7542	131419	6258	117982
Net profit		**17775**		**63968**

With reference to the income statement for CDE Pty Ltd, complete the following questions.

1 Describe the changes between 2020 and 2021 to the following:
   - a Total revenue
   - b Purchases
   - c Gross profit
   - d Net profit
   - e Operating expenses.

2 How do you calculate cost of goods sold?

3 Assess whether this business was more efficient in 2021 compared to 2020.

4 Identify the reasons why the net profit has increased from 2020 to 2021 even though sales and services show less revenue.

5 Evaluate the legal structure of this business.

6 Identify items that would be included under financial expenses.

7 Based on the small business tax rate of 27.5 per cent in 2020, calculate the tax liability of this business for 2020 and 2021.

8 Calculate the net profit after tax for this business in 2020 and 2021.

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Balance sheet A snapshot on a particular day (usually the last day of the financial year) that shows the assets a business owns, the liabilities the business owes and the equity the owner has invested in the business. The balance sheet gives an indication of the financial stability of a business. It represents the accounting equation A = L + E.

Balance sheet

The **balance sheet** gives a snapshot or summary of what the business owns and owes on a certain day (that is, its financial position on a specific date). Along with the income statement, it helps the financial manager determine if the business is reaching its financial objectives.

The balance sheet illustrates the relationship between the assets, liabilities and equity (A = L + E). The balance sheet can be analysed to determine the financial stability of a business in the short term and in the long term. The balance sheet is sometimes referred to as the statement of net worth or a statement of financial position.

Source 11.17 A balance sheet shows what the business owns and owes on a particular day.

Type of financial statement

Business name

The trading period covered by this report

Balance sheet for Happy Pet Products Pty Ltd as at 30 June 2021

Current assets	$	$	Current liabilities	$	$
Cash	13 000				
Accounts receivable	25 000		Accounts payable	37 000	
Inventory	80 000		Overdraft	7 000	
	118 000	118 000		44 000	44 000
Non-current assets	**$**	**$**	**Non-current liabilities**	**$**	**$**
Furniture & fittings	32 000		Bank term loan	42 800	
Vehicle	25 000		Mortgage	460 000	
Computers	10 000			502 800	502 800
Building	720 000		Total liabilities		546 800
	787 000	787 000			
			Equity		
			Capital	90 000	
			Net profit	268 200	
				358 200	358 200
Total assets		**905 000**			**905 000**

Assets that are expected to be converted to cash within 12 months

Bank balance

Total of amounts owed by customers for goods bought on credit

Value of stock still held by the business on 30 June 2021

Assets that generate revenue for the business over a period of more than 12 months

Debts the business owes and must pay within 12 months

Amounts owed to businesses that supplied goods/services on credit to the business

Short-term financial arrangement with bank to use bank funds up to a specified amount; interest is calculated on a daily basis

Obligations of the business to repay a debt over a period of time longer than 12 months

Long-term loan that uses property or another asset as collateral

Net worth of the business; the owner's claim on the business

Net profit as calculated in the income statement

Source 11.18 Balance sheet for Happy Pet Products Pty Ltd

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Activity 11.3
Balance sheet

Balance sheet for CDE Pty Ltd as at 30 June 2021

Assets	$	Liabilities	$
Current assets		**Current liabilities**	
Cash	6414	Accounts payable	25373
Accounts receivable	21462	Overdraft	13566
Inventory	58104	Credit card	10722
Prepaid expenses	500	**Total current liabilities**	**49661**
Total current assets	**86480**		
		Non-current liabilities	
Non-current assets		Mortgage	415000
Land & buildings	515000	Long-term loan	102931
Fixtures & fittings	102750	**Total non-current liabilities**	**517931**
Vehicles	27300		
Total non-current assets	**645050**	Equity	
Net profit		Capital	100000
		63938	
		163938	
Total assets	**731530**	**Total liabilities & equity**	**731530**

Refer to the balance sheet for CDE Pty Ltd to complete the following questions.

1 Deduce why the balance sheet is referred to 'as at' a particular date.
2 Describe how you could become a part-owner of this business.
3 Identify the total liability of this business.
4 Identify which financial statement is used to calculate the net profit figure.
5 Calculate the net worth of this business.
6 Identify the original investment by the owners.
7 Identify the key difference between current and non-current liabilities.

Review 11.2
Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Explain the following terms as they apply to financial statements:
   a Reliable
   b Understandable
   c Relevant
   d Comparable
2 Discuss the implications for a business if its financial statements are not reliable, understandable, relevant or comparable.
3 Identify the stakeholders that would use the financial statements of a business.
4 Research and revise some Preliminary course concepts:
   a What is the historical cost assumption for valuing assets on the balance sheet?
   b What are intangible assets and which financial statement do they belong to?
   c Explain the meaning of 'cartage inwards', 'cartage outwards' and 'prepaid expenses'.

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Scenario: J&J Designs

Revision of some Preliminary course material on the accounting equation may provide a clearer understanding of the sources of finance for a business. The following three common transactions utilise the accounting equation (A = L + E).

James and Julie were good friends at school, both studying Visual Arts for the HSC. They were always interested in designing jewellery for their friends and realised that there was an opportunity to make and sell jewellery for a young, wealthy female target market. They decided that after they finished school they would work together designing and selling their jewellery. They each had $2000 to put into their new business, a partnership they would call J&J Designs. As they were giving the business their own money as capital, the source of finance was internal equity. The money was deposited in a business bank account set up by James and Julie. The bank account represents an asset.

Assets	=	Liabilities + Equity
$4000		$4000

James and Julie knew they would need more money than $4000 to start their business and therefore needed to acquire additional finance from a source other than equity. The business would need to buy jewellery-making equipment as well as precious metals (gold, silver and platinum) and small gemstones. Based on their business plan, the two owners were able to obtain a bank loan for $6000 repayable over three years. This represents a liability for the business and is therefore recorded as a form of external debt finance.

Assets	=	Liabilities + Equity
$4000 + $6000	=	$6000 + $4000

The business now has $10 000 in finance available to buy assets to generate an income. This finance came from two sources: equity and debt. James and Julie contacted a supplier who was prepared to provide the business with $1500 of materials to make jewellery without immediate payment. The supplier delivered the materials and enclosed an invoice requesting payment within 30 days. This transaction represents $1500 in trade credit, which is a short-term liability and therefore a source of short-term external debt finance.

Assets	=	Liabilities + Equity
($4000 + $6000 + $1500)	=	($6000 + $1500) + $4000

Overall, J&J Designs has $11 500 in cash and inventory, which was paid for from $4000 in equity, $1500 in short-term debt and $6000 in long-term debt. For each of these transactions, there are two effects on the balance sheet that are both recorded using the accounting equation. In each case, the finance that is available has been obtained from a particular source. Therefore, the sources of finance will always equal the uses of funds.

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Activity 11.4
Calculation and classification

1 Using the accounting equation, Assets = Liabilities + Equity, copy and complete the table below by calculating the missing figures, labelled A–F.

Assets	Liabilities	Owner's equity
5 600	A	1 500
15 700	4 300	B
C	2 130	3 170
D	735	145
11 438	8 317	E
35 640	15 790	F

2 This activity is revision for the classification of accounts learned in the Preliminary course. Classify each of the following accounts as an asset, liability, equity, revenue or expense. In the final column, identify the financial statement involved.

	Classification	Financial statement
a Sales		
b Cost of goods sold		
c Accounts receivable		
d Lease		
e Mortgage loan		
f Inventory or stock		
g Advertising		
h Interest paid on loans		
i Bank overdraft		
j Company car		
k Equipment		
l Land and buildings		
m Owner's capital		
n Accounts payable		
o Tax on net profit		
p Telephone		
q Accountant's fee		
r Wages		
s Cash		
t Insurance		
u Retained profits		
v Debentures		

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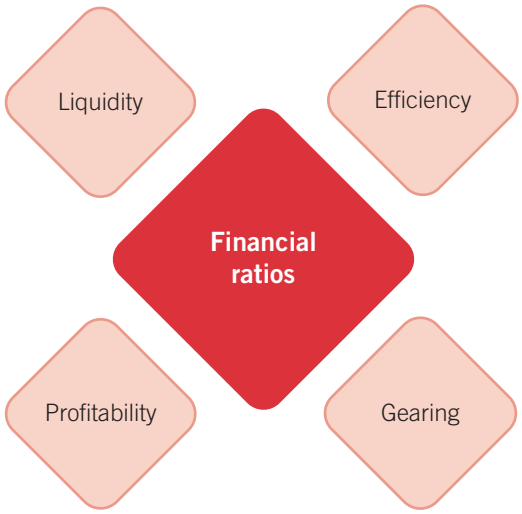
11.3 Financial ratios

Accounting is the systematic recording of transactions made over a period of time by a business. Accounting provides information on the resources available, how these resources were financed and the results achieved from their use. Information is summarised in the financial statements and compared to the previous year's results. Business financial performance is also compared with that of similar businesses in the same industry. By analysing the data, essential features of business activity can be identified and linked to business decisions. Financial managers can then provide greater understanding of the financial statements through the interpretation of financial ratio results, which helps managers make informed decisions. Ratios provide more information than the financial statements alone.

Current ratio This ratio, also known as the working capital ratio, is used to measure a business's ability to pay its current liabilities from its current assets. It is calculated by dividing the value of current assets by the value of current liabilities.

Gearing: debt to equity ratio This is a measure of how the assets of the business were funded through a mix of debt and equity. Higher debt indicates higher risk. It is a measure of the business's long-term financial stability.

Ratios using the balance sheet are used to assess the business's liquidity and gearing. Ratios using the income statement are used to assess the business's profitability and efficiency. Frequent review of ratios enables managers to determine and compare results, monitor trends, stay informed and have better control of their business. These ratios should be simple and quick to use.



Source 11.19 Objectives measured by financial ratios

Liquidity

The **current ratio**, which is also known as the working capital ratio, measures liquidity. It tells the manager if the business is financially stable in the short term (less than 12 months) and able to pay all its short-term liabilities using its current assets. Cash to pay liabilities can be obtained from the business's bank account, sale of inventory and payments received from account customers.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

A business will want more current assets than current liabilities (that is, a ratio greater than 1:1). However, a very high ratio (for example, 4:1), in which assets are much greater than liabilities, will be criticised as an inefficient use of working capital. The business will have too much cash left idle in the bank, spent on stock or waiting to be received from accounts receivable when this money could be put to better use paying off short-term loans and reducing interest expenses. However, if the current ratio shows the value of total current assets is less than the value of total current liabilities, the business is in a risky financial situation. If a creditor demands payment, the business is not liquid enough to pay the debt.

The income statement and balance sheet provide an accurate summary of a business's financial position.

Gearing (leverage)

Gearing ratios indicate a business's solvency (that is, its ability to meet its overall financial commitments as they fall due in the long term). The **gearing: debt to equity ratio** is a measure of how the assets of the business were funded through a mix of debt and equity – higher debt indicating higher risk for the business. It is a measure of the business's long-term financial stability. It gives an indication of how risky it is to buy shares or invest in the business. The higher the ratio of debt to equity, the more financially unstable the business is. A business in a risky position will have a high level of leverage, be highly geared and, hence, have a low level of solvency.

$$\text{Debt to equity ratio} = \frac{\text{Total liabilities}}{\text{Total equity}}$$

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When businesses have a higher level of debt, they are vulnerable to increased interest expenses, particularly when interest rates rise with an upswing in the economic cycle. As a general rule, a business should have more equity than debt. In some industries, an acceptable level of gearing is 40 per cent; that is, 40 per cent of funds in the business come from borrowed money and 60 per cent from equity. A business with gearing of less than 25 per cent is described

Source 11.20 Financial ratios

Ratio type and name	Formula	Results from analysis of CDE Pty Ltd income statement & balance sheet 2021 example in Activities 11.2 and 11.3	Interpretation
Liquidity			
Current ratio (working capital ratio)	$\frac{\text{Current assets}}{\text{Current liabilities}}$	1.74:1; $1.74 of current assets for every $1 of current liabilities	Acceptable ratio for CDE Pty Ltd. Generally, a ratio of 2:1 would be considered sound. If less than 1:1, the firm would have issues paying its current liabilities on time.
Gearing			
Debt to equity ratio	$\frac{\text{Total liabilities}}{\text{Total equity}}$	3.47:1 or 78% financed from debt (22% from equity); that is, $3.47 debt for every $1 equity	The higher the ratio, the higher the business risk and the lower its solvency. Generally, a business should have more equity than debt; however, it depends on the industry involved.
Profitability			
Gross profit ratio	$\frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$	77%; for every $1 of sales, $0.77 is made in gross profit	The higher the ratio, the better; usually expressed as a percentage.
Net profit ratio	$\frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$	27%; for every $1 of sales, $0.27 is made in net profit	The higher the ratio, the better. A low ratio would indicate the need to address the business's efficiency. Usually expressed as a percentage.
Return on equity (ROE)	$\frac{\text{Net profit}}{\text{Total equity}} \times \frac{100}{1}$	39%; for every $1 of equity, $0.39 is made in net profit	Need to compare the ratio with alternative forms of investment. The higher the ROE, the more easily the business will be able to raise funds for future growth. Usually expressed as a percentage.

Continued →

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Ratio type and name	Formula	Results from analysis of CDE Pty Ltd income statement & balance sheet 2021 example in Activities 11.2 and 11.3	Interpretation
Efficiency			
Expense ratio	$\frac{\text{Total expenses}}{\text{Sales}} \times \frac{100}{1}$	50.5%; for every $1 of sales, $0.505 is spent on expenses	The lower the ratio, the more efficient the business is; usually expressed as a percentage.
Accounts receivable turnover ratio	$\frac{\text{Sales}}{\text{Accounts receivable}}$ OR Number of days in a year, 365 (366 in a leap year) divided by the result from the following formula: $\frac{\text{Sales}}{\text{Accounts receivable}}$	Approximately 11 times per year; 34 days on average to pay	The higher the number of times per year, the greater the efficiency.The greater the number of days on average to collect accounts receivable, the lower the efficiency.

as having low gearing. The more the percentage increases, the more the business is financed from debt. A business that has over 80 per cent of its funds sourced from debt would generally be considered to have poor solvency and would find it harder to obtain more credit.

When interest rates are low, a higher level of gearing and a lower level of solvency are acceptable. A business can exploit the advantage of borrowing to invest in assets that will earn a much higher level of profit than the interest expense on the loans (for example, borrowing to open a second shop or factory from which profits can be earned by making and selling more goods). If interest rates rise owing to changes in government policy and the economic cycle moves towards a downswing, the business will need to reduce its level of gearing by paying off as much debt as possible.

If the business does not reduce its level of gearing, it must make repayments with a higher interest expense from falling profit. Profit falls as sales fall during periods of slower economic growth. The business will risk insolvency and bankruptcy if it does not reduce its gearing.

Acceptable gearing levels vary based on what the business's product is, its legal and financial structure, the industry it operates in and the level of activity in the economy.

Source 11.21 Business profits fall as sales fall during periods of slower economic growth.

Profitability

The income statement is used to determine how profitable the business is. Ultimately, the financial manager will wish to know that the returns offered by the business are better than any safer alternative investment, such as a savings account.

Subtracting the cost of goods sold from total sales revenue gives the gross profit. This is important for a retailer because it represents the money made from the core business activity,

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which is to sell inventory. The **gross profit ratio (GPR)** calculates for every $1 of sales how much gross profit the business makes after paying for the cost of goods sold (the amount it paid for the inventory it sold).

$$\text{Gross profit ratio} = \frac{\text{Gross profit}}{\text{Sales}} \times \frac{100}{1}$$

The ratio represents the mark-up or profit margin between the wholesale cost of the firm's inventory and the price the business sells it for. A result of 70 per cent tells us that for every $1 in sales the business makes $0.70 in gross profit. A small increase in the GPR indicates an increase in overall profitability. If the business cuts its prices, it will be decreasing its gross profit margin. Alternatively, if the business finds a cheaper supplier and keeps the price the same, it will have increased its mark-up.

The **net profit ratio (NPR)** calculates for every $1 of sales how much net profit the business makes after paying all expenses. A result of 25 per cent tells us that for every $1 in sales, the business makes $0.25 in net profit.

$$\text{Net profit ratio} = \frac{\text{Net profit}}{\text{Sales}} \times \frac{100}{1}$$

Minimising expenses will increase the resulting net profit and the return to the owners. Comparisons with other businesses should be made before tax because tax liabilities vary from one business to another and make comparisons more difficult.

The **return on equity (ROE) ratio** calculates the return that the owners receive for their investment in the business. In order to perform this analysis, figures from both the income statement and the balance sheet are needed. Owners will want to compare their return from the business with alternative investments they could make with their money.

$$\text{Return on equity} = \frac{\text{Net profit}}{\text{Total equity}} \times \frac{100}{1}$$

Some industries have a high ROE as they require few assets, while others need infrastructure before they generate profit; so ROE should compare companies in the same industry and use their past ratio results to establish trends. If a business has $100 million in capital and it makes $5 million profit, it will have a return of 5 per cent on its equity. The higher the ROE, the more easily the company will be able to raise money for future growth.

Efficiency

Efficiency ratios show how well the business manages its operations and resources, repays its liabilities, keeps expenses under control and efficiently collects its accounts receivable.

Actual expenses need to be compared to the proposed budget and related to fixed as well as variable costs. Ratio results can be compared to similar businesses in the same industry and to past results for the same business.

$$\text{Expense ratio} = \frac{\text{Total expenses}}{\text{Sales}} \times \frac{100}{1}$$

An expense ratio can also be calculated using individual expenses, such as:

- financial expenses (interest): – varies with level of debt, current rate of interest
- selling expenses (marketing costs): – advertising, promotions
- operations (manufacturing costs): – cost of wages, electricity.

Gross profit ratio (GPR) This ratio is a measure of a business's profitability before expenses. It is calculated by dividing the value of gross profit by the value of sales. The result is usually expressed as a percentage.

Net profit ratio (NPR) This ratio is a measure of a business's profitability after all expenses have been paid. It is calculated by dividing the value of net profit by the value of sales. The result is usually expressed as a percentage.

Return on equity (ROE) ratio This ratio measures the profitability of the business and the return generated for the owner's investment in the business.

Source 11.22 A retailer aims to sell inventory as quickly as possible.

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A retailer aims to sell inventory as quickly as possible. Any unsold goods are a cost to the business in storage and cash tied up in a less liquid form. A business would prefer to have this cash free to pay liabilities. The faster the sales occur, the higher the profit. If a business has an inventory turnover of 52 times a year, it will have to restock at the end of each week as all inventory is sold in seven days (that is, 365/52 ≈ 7).

Using the **accounts receivable turnover ratio**, the business can work out how many days it takes, on average, for account customers to pay their invoices. This result will be compared to the **credit policy** and procedures followed by the business to see if customers are taking far too long to pay. The following is a calculation of the accounts receivable turnover ratio for CDE Pty Ltd 2021 in Activity 11.3. Using the figures for sales in Activity 11.2 and accounts receivable in Activity 11.3, it can be seen that the accounts receivable turnover is 11 times a year (that is, 233 616/21 462). By dividing the number of days in the year by the turnover (365 days/11), it can be established that, on average, it takes approximately 34 days for account customers to pay their invoices. This will be an unsatisfactory result if the credit policy of the business is only 21 days.

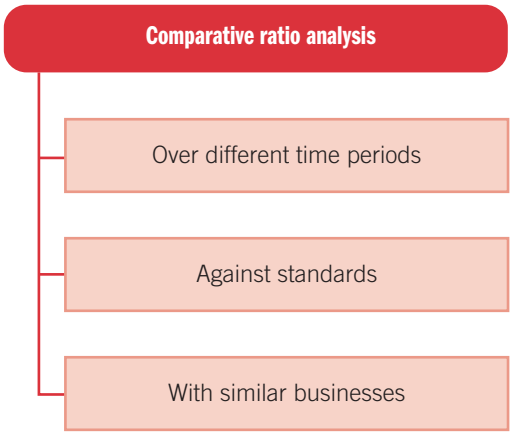
Accounts receivable turnover ratio This ratio is a measure of how long, on average, account customers take to pay the invoices sent to them by the business. It indicates how promptly customers who have been given credit pay for the products they have bought.

Credit policy The conditions under which a business is willing to allow other businesses to postpone their payment for goods and services they have bought from it; for example, how many days are permitted to pass before payment is due.

$$\text{Accounts receivable turnover ratio} = \frac{\text{Sales}}{\text{Accounts receivable}}$$

Comparative ratio analysis

The ratios that are calculated using the financial statements are used to make comparisons over different time periods, against standards and with similar businesses. By comparing the current year's results to those of previous years, the financial manager will be able to identify trends in profit, costs and financial stability. The financial manager will want to determine if the business is reaching its financial objectives of increasing profitability, growth, efficiency, liquidity and solvency.



Source 11.23 Ratios are used to make comparisons.

The financial manager will also compare the results to those of other businesses and established standards in the same industry. This is called benchmarking. The manager will want to establish whether the business's performance is above average. If the results are below the industry standard, then the business plan will need to be reviewed and new strategies introduced. The business will try to determine where improvements can be made and identify how other businesses have achieved higher performance. It must be remembered that private companies only make their financial statements available to their shareholders, the ATO, ASIC and possibly to financial institutions when they wish to borrow funds. Therefore, industry data may be all they have to compare to. Public companies make their annual reports available to the general public.

The financial manager will also compare the results of the business to what is considered to be the best possible result. A standard, benchmark or key performance indicator (KPI) is the result that the business is aiming for in its objectives. This benchmark may be a global standard. (In this case, it is called world's best practice.) The manager will want to know how their Australian business compares against the best in the world. For example, the manager may want to determine the best profit result possible, given the resources the business has and how efficient the business can be.

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Some generalised standards have been worked out for ratios that are considered by financial analysts to be ideal results. These are:

- liquidity – current assets should be 1.2 to 2.5 times greater than current liabilities
- return on equity – this result should be greater than the current interest rate
- gearing – debt to equity ratio – this result should be no higher than 60 per cent.

Activity 11.5
Calculation

Use the income statement below to complete the questions that follow. Industry profitability average is 10 per cent.

Income statement for Average Joe Ltd

For the period ending 30 June 2021			
	2019	**2020**	**2021**
	$	**$**	**$**
Sales revenue	208 000	295 000	362 000
less Cost of goods sold	96 000	135 500	222 500
Gross profit	112 000	149 500	139 500
less Operating expenses			
Financial expenses			
Interest	900	950	1 150
Selling expenses			
Advertising	11 600	15 450	19 550
Wages	30 900	36 000	45 200
Administrative expenses			
Wages	32 000	33 500	37 000
Electricity	1 000	1 100	1 200
Insurance	4 500	4 800	5 300
Lease	2 000	2 000	3 000
Stationery	600	700	600
Total expenses	83 500	94 500	113 000
Net profit before tax	**28 500**	**55 000**	**26 500**

1 Calculate the gross profit and net profit ratios for 2019, 2020 and 2021. Comment on the changes.
2 Calculate an efficiency ratio using total expenses for 2019, 2020 and 2021. Comment on the changes.
3 Extrapolate any possible reasons for the decrease in gross profit in 2021.

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Activity 11.6
Assessment

1 Use the balance sheet below for Fairyland Hotel Pty Ltd to assess the trend in financial stability by comparing the results of the calculations for the current ratio and gearing: debt to equity ratio to the industry average.
2 Compare the results of the 2021 balance sheet to the figures for 2020. Is this business financially better or worse off? Give reasons for your conclusion.

Industry average: liquidity is 2:1; solvency/gearing is 90 per cent.

Balance sheet for Fairyland Hotel Pty Ltd

As at 30 June 2020 and 2021		
	2020	**2021**
	$	**$**
Current assets		
Cash	1000	1000
Accounts receivable	2000	4000
Inventory	15000	15000
Total current assets	18000	20000
Non-current assets		
Equipment	12000	13000
Motor vehicles	36000	43000
Total non-current assets	48000	56000
Current liabilities		
Bank overdraft	2000	1000
Accounts payable	4000	9000
Total current liabilities	6000	10000
Non-current liabilities		
Mortgage loan	40000	37000
Total non-current liabilities	40000	37000
Equity		
Capital	10000	10000
plus Retained profit	16000	23000
less Drawings	6000	4000
Total equity	**20000**	**29000**

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Review 11.3

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Identify which financial statement is required to calculate each of the following:
   a profitability
   b solvency
   c efficiency
   d liquidity.
2 Explain how a financial manager may use financial ratios to analyse the financial performance of a business.
3 Using the income statement for CDE Pty Ltd for 2020 and 2021 (Activity 11.2), calculate for 2020:
   a gross profit ratio
   b net profit ratio
   c selling expenses ratio
   d administration expenses ratio
   e financial expenses ratio.
4 Compare your results for Question 3 with the results in the summary table of ratios providing 2021 results (Source 11.20). What changes can you identify?

Source 11.24 Benchmarking is comparison with other businesses and established standards in the industry.

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11.4 Limitations of financial reports

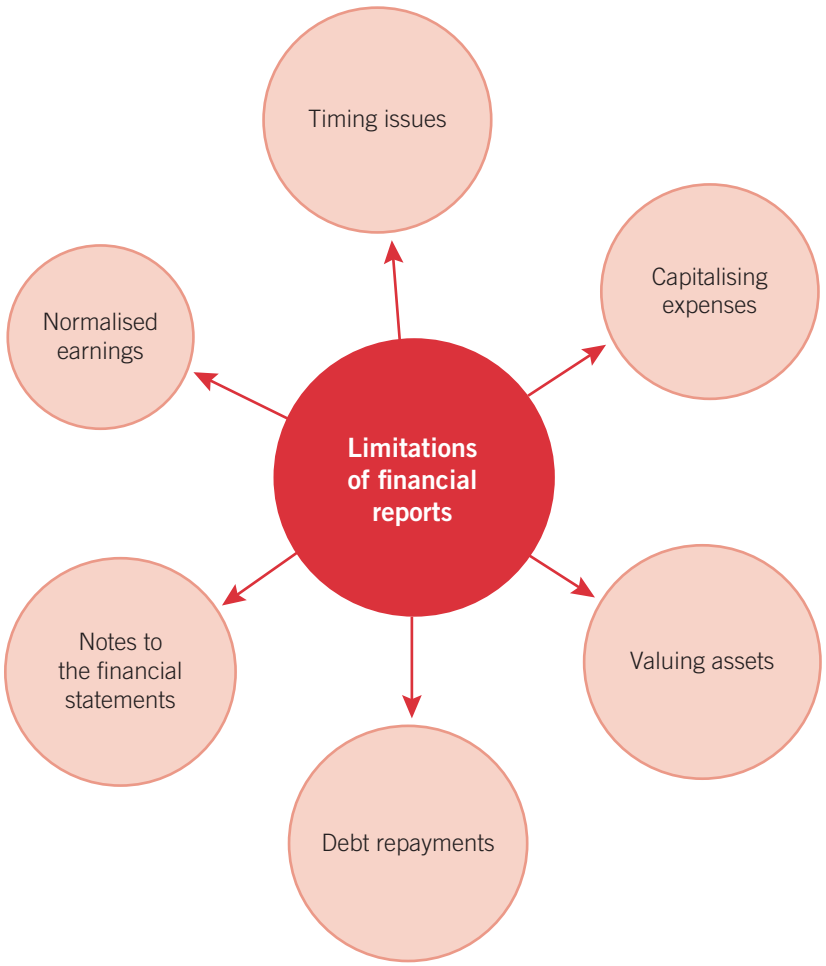
Financial statements do not tell the whole financial story of a business. The rules followed to produce them can create a misleading impression of a business's profitability and value. In accounting, statements must be reliable; that is, the values and data must be accurate and be verifiable by an independent expert. This is known as the reliability principle. In reality, the business may be quite different from what is recorded on paper in the income statement and balance sheet. The income statement may not give a clear picture of a business's profitability. One of the limitations of financial statements is the way they are written and presented. Complicated and detailed accounts will confuse individuals who do not have a background in accounting. In the past, many large international businesses have attempted to reduce their tax liability in Australia through complicated intra-company transactions. As a result of this, the 2016 Budget established a diverted profits tax, instituting a 40 per cent penalty tax rate on large multinationals that try to avoid paying tax by moving their Australian profits. The ATO has linked Australian tax law with Organisation for Economic Co-operation and Development (OECD) guidance to better align transfer pricing outcomes with value creation, and since June 2018 has completed country-by-country reports for significant global entities. Most businesses try to minimise their tax liability. (This should not be confused with tax evasion.) A key limitation of the balance sheet is that it does not show how long a business has been carrying its liabilities for or how long each debt has been owed for.

Normalised earnings The earnings adjusted to take into account cyclical upswings or downswings in the economy, or to remove one-time influences.

Normalised earnings

Normalised earnings are earnings adjusted to take into account a cyclical upswing or downswing in the economy, or adjusted to remove one-time influences (such as the sale of land owned by

Source 11.25 Financial reports have a number of limitations.



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a manufacturing company), leaving only the normal income sources on the balance sheet. In this way, the earnings would show a more accurate representation of the real earnings of the business's operations.

Capitalising expenses

Capitalised expenses are the costs incurred when financing a non-current asset. (For example, the purchase of a factory site would involve payment for legal fees and stamp duty; or the research and development costs associated with a new product.) When placed into the accounting framework, these expenses are capitalised (that is, added to the cost of the asset). They are therefore treated as an asset and not as an expense.

Capitalised expenses are not deducted from revenue in the period they were incurred. Instead, they are deducted through **depreciation** over time, as the asset will be generating revenue over several years, thus matching the overall expense with the revenue earning period. The amount for the item is recorded in the balance sheet and not as an expense in the income statement.

Valuing assets

When an asset is listed on the balance sheet, its value is written at its historical cost, which can be verified (for example, through an invoice and receipt for the purchase) – that is, the original cost of the asset when it was bought. The reason assets are valued this way is to make sure every business values its assets in the same manner. It means there is consistency between businesses and comparisons between businesses can be made. However, the original cost of an asset on the balance sheet is different from its current market value, so even if the depreciated value is recorded in the balance sheet, it can be quite different from its market value. If the business sells an asset, the cash it receives will be different from the historical cost of the asset. Some assets lose value through wear and tear, and others may increase in value. For instance, the land a factory is located on can over time be worth far more than what the business originally paid for it. If a business wishes to revalue its non-current assets, it must have them valued by an independent, objective individual expert or business. Accountants write off some assets over time through depreciation, matching the value of depreciation to the fall in value of the asset each year. This depreciation rate may vary for different assets and over different time periods.

Capitalised expenses The costs incurred when financing a non-current asset added to the cost of the asset.

Depreciation (of assets) Occurs where assets (such as motor vehicles and equipment) lose value over time owing to wear and tear and the development of new technology.

Source 11.26 Business assets such as motor vehicles depreciate in value over time through wear and tear.

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Business Bite

In July 2020, a *Renew Economy* article by Michael Mazengarb highlighted the effect of the COVID-19 pandemic on energy prices. Volatile prices per barrel for oil worldwide sent prices crashing, dropping from $60 and eventually stabilising at $40 a barrel. As gas prices were linked to oil, the price of gas also fell. Many businesses had previously invested heavily in energy. Along with increased uncertainty in the energy market, many of the large energy providers, such as Santos' investment in the Gladstone LNG project, were forced to write down their investments. Amounts written off by energy companies included:

- Origin Energy $1.2 billion
- Woodside $6.3 billion
- Oil Search $570 million
- Shell $22 billion
- Strike Energy $91 million.

Conservatively, Australian investment losses in the oil and gas sector could be more than $18 billion for the first half of 2020. This may also indicate the need to move towards cleaner energy projects for future job creation. This could include areas such as renewable energy, ecosystem restoration and the collection and processing of organic waste.

Source: Michael Mazengarb, 'Santos latest to write down gas investments, as total Australia losses near $20 billion' 21 July 2020, reneweconomy.com.au/santos-latest-to-write-down-gas-investments-as-total-australia-losses-near-20-billion-26668/.

Intangible asset An asset that does not physically exist and therefore is not written on a business's balance sheet unless the business is to be sold. However, it is of value to the business because it can earn revenue from the asset. Intangible assets include a business's good reputation, trademark, design or brand name.

Trademark A symbol or name that a business uses and has registered to represent its product. It is part of a business's intellectual property.

Goodwill An intangible asset valued according to the advantage or reputation a business has acquired over time.

Warranty An agreement by the seller of a product that the seller will be responsible for the repair or replacement of the product if it is found to have a defect in its quality, condition or quantity.

Another limitation of financial statements is that the financial manager cannot record all types of **intangible assets** on the balance sheet, such as goodwill, patents, **trademarks**, brand names and patents. Patents are the legal protection a business can obtain to prevent other businesses copying its ideas.

Although **goodwill** is an intangible asset, it is often included as a balance sheet item when a business is to be sold. The business may have regular customers who are loyal and guarantee the business future sales. Goodwill cannot be sold separately from the business and there is no consistent rule to work out its value. A financial manager could be tempted to include and/or overvalue intangible assets to make the business appear more financially stable than it really is; such was the case for ABC Learning Centres, which revalued goodwill based on its estimates of its future cash flow. When the business collapsed, much of ABC's assets actually did not exist.

Intangible assets can also lose value over time for the same reasons as tangible assets depreciate. This is called amortisation. For example, a patented invention may be replaced by a more technologically advanced product.

Finally, some liabilities and future expenses have to be estimated because it is hard to determine the future debt that may be incurred. For instance, it is difficult to estimate the future costs that will be incurred repairing and replacing faulty goods that are under **warranty**.

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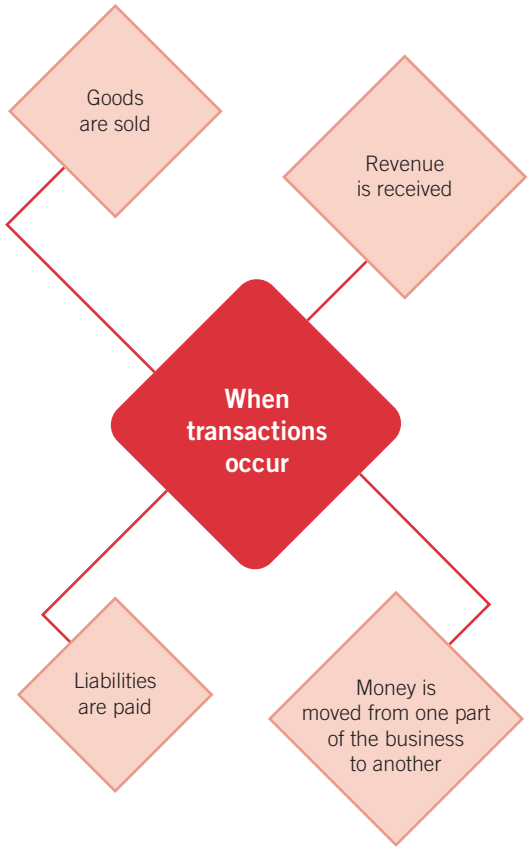
Timing issues

Accountants may adjust the timing of revenue inflows and debt repayments to make the business appear more profitable. They could delay banking revenue until the start of a new financial year in order to decrease the business's current taxation commitment. This would delay revenue and incur a tax liability for the following year. Prepaying expenses may provide businesses with an additional tax deduction for the current financial period. They would argue that the finance was available; they have gained future services and so on at a reduced cost to the business and also possibly secured a valuable input for future operations. However, the matching principle requires that transactions are recorded when they occur and that revenue should be matched to the costs involved in earning that revenue.

Financial managers may also use a shorter accounting period (less than a year) to avoid including transactions that would affect the business's profitability or financial stability. The income statement and the balance sheet do not indicate seasonal variations or peak time demand periods.



Source 11.27 When transactions occur

Business Bite

Financial years vary around the world, making financial statements more difficult to compare. In some countries, the government has a different financial year from companies and individuals.

	Calendar year 1												Calendar year 2											
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Australia						■	■	■	■	■	■	■	■	■	■	■	■	■						
United States										■	■	■	■	■	■	■	■	■	■	■	■			
United Kingdom				■	■	■	■	■	■	■	■	■	■	■	■									
New Zealand (govt)	■	■	■	■	■	■	■	■	■	■	■	■												
New Zealand (corp. and pers.)				■	■	■	■	■	■	■	■	■	■	■	■									
Japan (govt)				■	■	■	■	■	■	■	■	■	■	■	■									
Japan (corp. and pers.)	■	■	■	■	■	■	■	■	■	■	■	■												
China	■	■	■	■	■	■	■	■	■	■	■	■												

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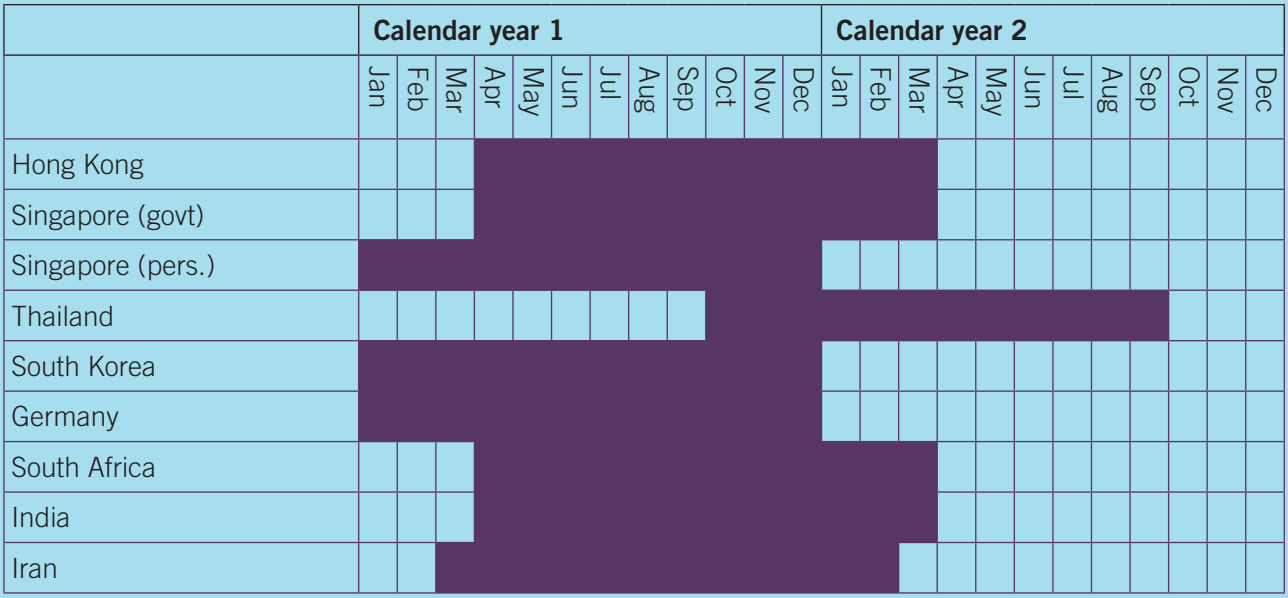

Source 11.28 Financial years around the world

Debt repayments

A business's funds need to be set aside to provide for future liabilities. Businesses may set up loyalty programs, such as the Qantas Frequent Flyer program, that provide customers with free goods and services when they have accumulated enough points.

Staff members may have accumulated holidays or long service leave and require a payment for holidays they are owed when their employment is terminated. It will be difficult to determine exactly when a payment for entitled leave is required or when wage costs will rise for replacement staff who are hired to cover vacationing employees. A business may also roll over debt finance and thus put off repayments until a later date. In accounting, this is termed 'accrued liabilities'. Businesses may set aside finance to pay these obligations at a later date as provisions.

Businesses also need to have procedures in place to recover debts such as outstanding accounts receivable. They do not indicate the debtor's ability to pay the account, how long the debt has been outstanding or even if there has been any attempt made to collect the debt. Some may leave these accounts on their books and not declare them to be bad debts so that the business appears more favourable to investors and lenders. This would overvalue the level of working capital of the business and undervalue the real risk of the business's operations.

Business Bite

The Qantas Frequent Flyer program, which has been operating for more than 30 years, has over 500 partners and includes Airbnb, Samsung and Jaguar Land Rover. It has also renewed its partnership with Woolworths. Under the partnership deal, partners pay Qantas for the points to help boost their customer base. People redeem points for flights and other goods and Qantas benefits from unused and expired points. As long as the airline sells the points for more money than it costs to redeem them, the airline benefits. It also launched the Qantas Premier credit card in June 2017, which also earns points. It is estimated that Qantas earned approximately $1.3 billion for its points over five years, with $369 million earned in 2017. It has about 11.8 million members.

Continued →

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According to Lifehacker Australia, August 2020, the Australian Bureau of Statistics estimated that the average Australian spends $74 000 a year on everyday purchases. This is worth about 74 000 Qantas Points if you make those purchases with a credit card that earns Qantas Points (especially the Qantas Premier credit card). This could be redeemed for return Economy flights from Sydney to Auckland, Hobart, or practically anywhere in Australia (noting that you also need to pay taxes, fees and carrier charges).

Notes to the financial statements

Stakeholders should read the 'Notes to the financial statements', which is additional information normally at the end of the financial report. These notes provide details about items included in the balance sheet and income statement. They could include methods of recording transactions, pension plan details, and intercompany or director loan debts. The notes provide a deeper understanding of a transaction, how it was calculated and why it was recorded in a particular way. However, even though these notes provide relevant information, they may be numerous and laypeople may not find all of them understandable.

11.5 Ethical issues related to financial reports

Changes in social attitudes have forced business owners and managers to consider the ethics of the decisions they make. They must ensure their decisions are judged to be morally correct, socially and environmentally responsible and 'the right thing to do'. They must look after the people they employ, the natural environment in which they operate and the local community in which the business, its owners and its employees live.

Accountants are expected to display integrity, objectivity, confidentiality and a high level of professional and technical ability. Chartered Accountants Australia and New Zealand oversees and sets accounting standards that must be followed in the preparation of financial reports. However, some financial managers will try to stretch the boundaries set by these rules. Financial managers and accountants must not 'be creative' when recording transactions and preparing financial reports in order to make the business appear more profitable and financially secure. A report could show a higher share value to attract investment, make it easier to acquire debt finance, have better relationships with suppliers and experience higher sales owing to its good reputation.

The collapses of Masters Hardware, Dick Smith and Queensland Nickel were all unexpected. Many thousands of employees lost their jobs overnight. Investors lost their assets, while senior executives received enormous payouts despite in many cases having mismanaged their businesses. In recent years, society has become increasingly aware of the actions of senior company executives and has questioned their behaviour and accountability.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Since 1 July 2004, amendments to the *Corporations Act 2001* (Cth) mean companies have to reveal the details of the salary packages of their directors and executives. This forces companies to be more honest and transparent in their behaviour. In addition, there is now greater pressure from shareholders and society for directors and executives to perform according to what they earn.

Managers may misuse business funds by using the business's credit cards for personal expenses. This is an unethical use of company funds. Improved internal controls could eliminate this problem.

Businesses can act in a more socially responsible and environmentally sustainable manner by formally recognising the wider costs or impacts of their business. As well as reporting on the profitability of a business, **triple bottom line (TBL)** based reporting provides a more balanced and enhanced non-financial disclosure, allowing an organisation to be better prepared for more intangible challenges and opportunities, such as reputation. Directors

Triple bottom line (TBL) A measure of a business's financial, social and environmental performance.

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have a legal duty to act in good faith, and their decisions and actions need to be transparent to their shareholders as well as the general public.

Some businesses prefer to operate only on a cash basis. This may allow them to only record revenue when an invoice or receipt is issued, thus leaving them in a position to understate income and effectively avoid paying taxes. The ATO monitors and audits businesses sporadically to catch any business attempting tax evasion. Proper record-keeping, the introduction of the goods and services tax (GST) and the business activity statement (BAS) requirement have made it more difficult to evade taxes.

Audit An independent check of the financial records of a business by a certified accountant. Alternatively, it can be performed by the business's managers.

An **audit** is an independent check of the financial records of a business by a certified accountant to ensure that the financial reports represent a true and fair financial picture of the business. Audited accounts are a legal requirement of all public companies, clubs and associations each year. Internal audits can be performed by a business's managers. Audits are necessary because stakeholders need to be able to trust annual reports, owners need accurate profit results, businesses wish to minimise tax liability, and managers need to be able to make informed decisions. The International Financial Reporting Standards are incorporated within Australia's Accounting Standards to increase transparency and accountability for all businesses. This includes companies that might claim spending funds on research and development of a new product as an investment asset rather than an expense.

Auditors may find serious issues such as: inappropriate cut-off periods to avoid additional tax commitments; misuse of business funds by executives; overstated expenses; or inappropriate asset valuations.

In some cases, financial reports have many assets valued at historical cost (original purchase price) or have an undervalued share price or low profitability. These undervalued businesses are targets for unethical corporate raiders. Raiders take over the undervalued businesses and strip them of their assets for profit.

Source 11.29 Improved internal controls could curb the unethical use of company funds.

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Review 11.4

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Discuss why a financial manager would internally audit a business.
2. Outline the advantages of internally auditing a business.
3. Identify the disadvantages of relying solely on computer-based accounting systems.
4. Explain the term 'creative accounting'.
5. Propose a reason why a financial manager may choose to make a business's financial position, as recorded in the financial reports, appear better than it really is.

Business Bite

The Australian Taxation Office (ATO) must ensure the integrity of our tax and superannuation system. Therefore, it must prevent, detect and respond to fraud and corruption to meet that commitment. The Fraud and Corruption Control Plan complies with the requirements of section 10 of the Public Governance, Performance and Accountability Rule 2014 and Commonwealth Fraud Control Framework 2017. Strategies are in place to address both internal and external fraud and corruption and are reviewed annually to ensure they can deal with our dynamic economic environment. As outlined by the ATO, for an activity to be fraud, it must be dishonest and lead to a direct or indirect benefit to an individual or group.

Internal fraud is committed by employees or contractors, and can include:

- falsely claiming employee benefits
- accessing and disclosing taxpayer information without authorisation
- falsifying qualifications
- improperly reducing a debt or other liability
- releasing funds without proper authority
- using ATO assets for personal benefit.

External fraud is committed by taxpayers and other third parties dishonestly and intentionally, and can include:

- failing to declare all income
- providing a false payment summary
- claiming a deduction to which you are not entitled
- lodging a false business activity statement
- identity crime enabled fraud
- failing to remit PAYG withholding and/or superannuation guarantee.

The ATO defines corruption as 'the dishonest or biased exercise of Commonwealth public official functions'.

Examples of corruption, such as by public officials, can include:

- abuse of office (for example, provision of sensitive information to facilitate external fraud committed by others)
- biased tax-related decision-making by ATO officials
- nepotism (particularly in relation to employment)
- collusion for personal gain.

In 2019, there were more than 1000 successful prosecutions, resulting in 1094 criminal convictions, reparation orders of $229 458 and fines of $8.248 million.

Source: https://cambridge.edu.au/redirect/9587.

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Chapter summary

Financial management is responsible for the financial planning of the business. Financial managers must determine the financial needs of the business, set budgets, develop record systems, instigate controls and analyse the financial risks of the business.

A budget is a plan in money terms or units about what the business wants to achieve, and it monitors revenue and expenses of the business's various departments.

Budgets establish standards and can be used as control tools.

Record systems must be accurate, reliable, efficient and accessible.

A business may acquire funds from both equity and debt sources. Equity is invested in the business in exchange for ownership. Debt is made up of borrowed funds that have to be repaid with interest.

Financial managers must match the type of debt finance and the term of the loan to the economic life of the asset it is used to purchase.

Financial statements need to communicate relevant, reliable and clear information about the business for the stakeholders. They must be prepared according to Australian accounting standards.

The three main financial statements are the cash flow statement, the income statement and the balance sheet.

A cash flow statement summarises the cash transactions that occurred over a specific period of time.

The income statement is a summary of the income and expenses of a business over a set period of time. It enables a financial manager to calculate total revenue, cost of goods sold, gross profit and net profit. It summarises the profitability and efficiency of the business over the period.

The balance sheet gives a summary of the assets, liabilities and equity of the business as at a particular date. Information from the balance sheet can also be used to determine the business's financial stability, net worth, liquidity and gearing.

Assets = liabilities + equity

Ratio results may also be compared with industry averages through benchmarking, world's best practice and the results of direct competitors.

Financial ratios are management tools used to analyse the financial statements of a business. The main ratios include:

- liquidity – current ratio
- gearing – debt to equity ratio
- profitability – gross profit ratio, net profit ratio and return on equity ratio
- efficiency – expense ratio and accounts receivable turnover ratio.

By comparing the results of the most recent ratio calculations with those for the corresponding period for previous years, a financial manager can determine changes and trends in the financial performance of a business and whether it is reaching its objectives.

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Financial statement limitations include the following:

- Assets such as land and buildings can appreciate in value over time, while other assets, such as company cars and equipment, can depreciate. However, they are recorded at their original historical cost on the balance sheet. Cost of non-current assets may also be capitalised.
- Intangible assets are usually not recorded on the balance sheet because their value is not independently verifiable. Goodwill will be added to the price of a business when it is for sale.
- There will often be differences in the asset values recorded in the financial statements and their values in the real world.
- Earnings may be normalised or hidden by timing issues.
- Debt payments may be rolled over.

Audited accounts are a legal requirement of all public companies. They are an independent check that financial reports represent a true and fair financial picture of the business.

Australian Accounting Standards (incorporating the International Financial Reporting Standards) regulate how financial reports are to be prepared.

In Australia, businesses cannot alter the accounting period to manipulate the financial records to make the business appear more profitable or financially secure than it actually is.

Ethical issues include understating revenue, overstating expenses, misuse of business funds and tax evasion. These have led to the need for an increased number of audits, and to the introduction of GST, BAS, executive salary based on performance, and the triple bottom line.

End-of-chapter tasks

Chapter revision tasks

1 Recall and write the accounting equation.

2 Explain the impact of the following transactions on the accounting equation for a business.

A The owner pays his suppliers $4000 and now has no trade credit to pay back.

B Customers pay off their credit accounts to the business.

C The business purchases new computers paying cash.

3 Explain the difference between the cash flow statement and the income statement.

4 Explain the difference between liquidity and solvency.

5 Deduce what information a financial manager may gain by comparing the business's results for financial ratios to industry averages and over time.

6 Explain why assets are depreciated and their revised value recorded on the balance sheet.

7 Explain why goodwill is normally not recorded on the balance sheet, despite its being commonly accepted as an asset.

8 Identify six main areas of limitation of financial reports.

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9 Explain why tax evasion is considered not only illegal but also unethical.

10 Explain why you would complete the income statement before the balance sheet for a business at the end of the financial year.

Multiple-choice questions

1 Which of the following is an example of a current asset?

A Net profit
B Goodwill
C Accounts receivable
D Accounts payable

2 A business uses the liquidity ratio to determine:

A the level of debt.
B the effectiveness of revenue controls.
C the effectiveness of working capital management.
D the level of expenses.

3 Which ratio would be used by a potential investor to determine the level of risk of the business?

A Current ratio
B Debt to equity ratio
C Return on owner's equity ratio
D Expense ratio

4 Seoul Computing Company sells computing equipment wholesale to computer retailers. The business gives its customers credit terms of 30 days net. However, its accounts receivable turnover ratio is 45 days. What does this mean for the management of account customers?

A The business's customers are paying every 30 days.
B The business's customers are taking too long to pay, affecting cash inflow.
C The business has offered more relaxed credit terms.
D The business offers its customers 45 days to pay.

5 A business has a gearing ratio of 4:1. How can this be interpreted for the business?

A It is highly geared and has poor solvency.
B It has low gearing and high solvency.
C It has more equity than debt.
D It has a low level of leverage.

6 What do efficiency ratios measure?

A The output of the business
B The control over costs in a business
C The value of expenses compared to cost of goods sold
D The effectiveness of management in achieving a profit

7 Below is selected financial information for a business:

Owner's equity $130 000

Current assets $50 000

Non-current assets $150 000

Non-current liabilities $40 000

Calculate the working capital ratio for this business.

A 0.6:1
B 1.2:1
C 1.7:1
D 2:1

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8 The Australian financial year is:

A from 1 July to 30 June the next year.
B from 31 July to 1 June the next year.
C from 1 January to 31 December.
D divided into quarters of six months.

9 If the accounts receivable are collected on average every 60 days, the accounts receivable turnover ratio would equal:

A 12
B 8
C 10
D 6

10 Little Mates Pty Ltd purchased the building that it previously rented to operate its business. This asset would be recorded at its original purchase price. This is referred to as:

A historical cost.
B capitalising expenses.
C normalised earnings.
D market value.

Short-answer questions

1 Explain the strategies that a business can use to control its cash flow.

2 Discuss the reasons why a business may act unethically to protect the financial interests of internal stakeholders.

Extended-response question

Evaluate how and why a business would manipulate its financial reports.

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12 Financial management strategies

Chapter objectives

In this chapter, students will:

- investigate financial management strategies
- explain cash flow management
- analyse how working capital management functions
- explain profitability management
- evaluate global financial management strategies.

Key terms

- appreciation
- bad debts
- budget
- cash flow management
- cost centres
- credit rating
- derivative
- euro
- exchange rate
- fixed costs
- hedging
- insurance premium
- on-costs
- payment in advance
- sales forecast
- sales mix
- stock movement
- subsidiary
- transaction exposure
- variable costs
- working capital
- write off

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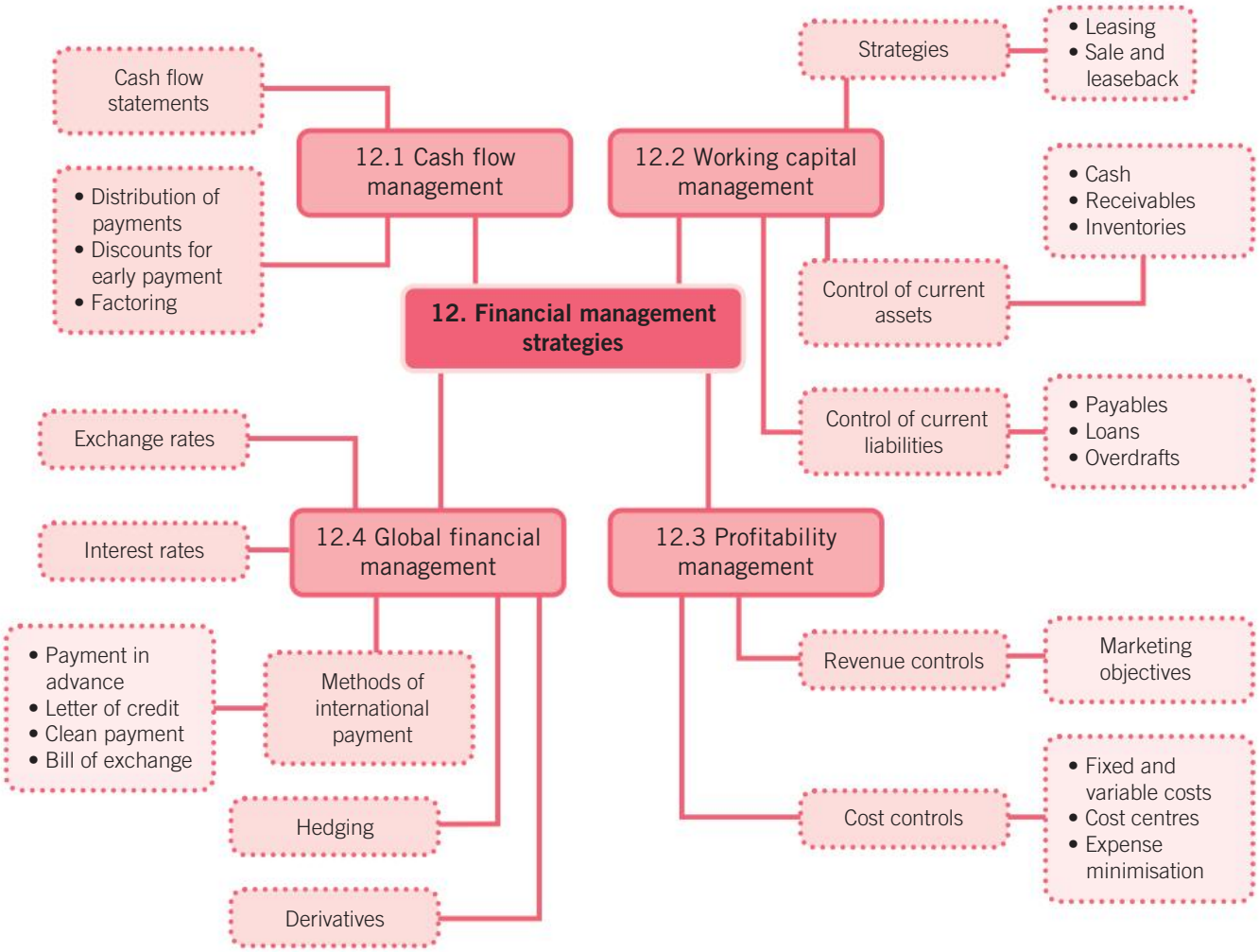
12.0 Introduction



Source 12.1 Financial management strategies concept map

Strategic financial management is managing a business's financial resources so as to achieve its business goals and maximise the business's value. Management will need to identify its financial objectives, determine its current position, analyse information and make financial decisions that will grow the business in the long term.

Good financial management will help a business to:

- make effective and efficient use of resources
- achieve objectives and fulfil commitments to stakeholders
- become more accountable to stakeholders
- gain the respect and confidence of the community
- gain an advantage over its competitors
- prepare for long-term financial sustainability.

The four main areas for financial management strategies include cash flow management, working capital management, profitability management and global financial management.

Digital quiz
Please see the Interactive Textbook to access digital activities.

12.1 Cash flow management

One of the biggest problems for most businesses is maintaining their liquidity. A business must always have enough cash available to pay expenses such as:

- rent due each month
- leasing costs for the company car
- monthly phone bill and internet service
- wages of staff.

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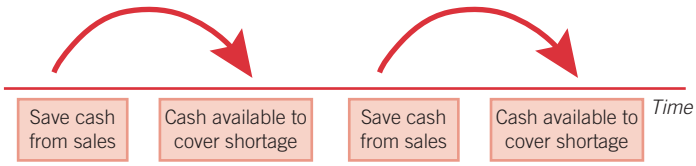


Source 12.2 Managing cash flow

A financial manager can draw up a **budget** to anticipate how much cash the business will need. A budget is a tool to evaluate the performance of a business by comparing actual results with planned results. A budget is usually drawn up as a spreadsheet illustrating the changes in data over weeks or months. Some months will be more expensive than others and therefore the financial manager needs to be prepared. A business may have plenty of non-current assets and a lot of cash tied up in accounts receivable. However, it can still go bankrupt if it does not have adequate liquidity. A creditor, such as a bank, can put a business into receivership for not being able to pay its loan instalments.

A budget can also limit spending by individual departments by allocating them a specific amount with which to complete their projects. For example, they cannot employ an additional staff member if they do not have sufficient funds in their budget to pay them.

Budget A tool to evaluate the performance of a business by comparing actual results with planned results. A budget is usually drawn up as a spreadsheet illustrating the changes in data over time, such as weeks or months.

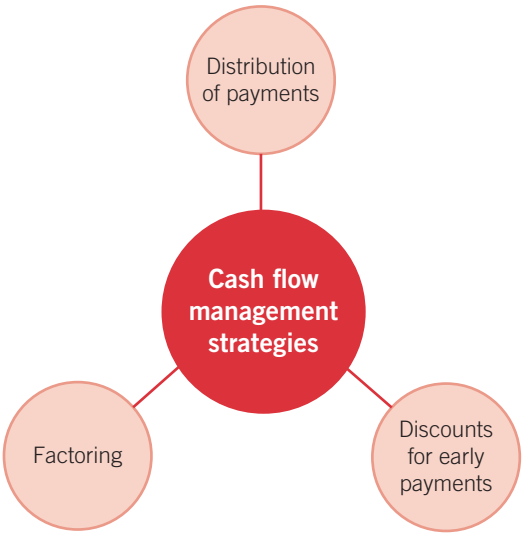
Cash flow management Managing the movement of cash into and out of a business in order to identify cash flow problems and ways to improve the business's liquidity.

Cash flow statements

Cash flow statements are sometimes referred to as continuous, or rolling, cash budgets. This financial report is used to show the pattern of short-term management of cash inflow and outflow.

Sources of cash inflow and outflow are listed in Source 12.4. The cash flow statement summarises how the business will pay for short-term liabilities with proceeds from operations based on the owner's knowledge of the market, figures from the previous year and external influences (such as competitors). By creating a cash flow statement of predicted cash flows, managers can prevent a cash shortage by planning ahead. It is possible to predict when cash will be needed and retain cash from earlier periods when cash inflow is much higher, thereby avoiding the need for more debt. If the business does expect to need more debt finance owing to a cash shortage, it is able to shop around earlier for the cheapest interest rate for short-term loans and overdrafts. An overdraft will allow the business to withdraw more money than it actually has in its bank account up to a specific amount agreed to by the bank. Interest is charged daily on the balance outstanding. (For more detail on cash flow statements, refer to Chapter 11.) A number of strategies can be used to assist with **cash flow management** problems, such as retaining cash from more profitable months, reorganising distribution of payments (outflows) and possibly providing discounts for early payment on credit accounts.

Source 12.3 A number of strategies can be used to manage cash flow.



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Source 12.4 Sources of typical cash flows

Cash in	Cash out
Payments for goods/services by customers	Payments to suppliers
Sales/fees/commission	Payments to employees
Collections of accounts receivable	Payment of expenses (e.g. electricity, stationery, insurance)
Receipt of a bank loan	Interest paid on loans
Issue of shares	Payment of dividends
Investment activities – dividends received	Loan repayments
Collection of loans	Cash payments to buy non-current assets
Interest earned from savings	Reducing the overdraft
Rebates, discounts and refunds received	Drawings
Sales of assets	

Distribution of payments

A business can ensure that all large, predictable expenses do not occur at the same time. By spreading expenses over the whole year, the business will have a more equal cash outflow each month rather than one huge outflow during one month. Many insurance companies offer the choice of paying insurance premiums monthly instead of annually because of their high cost. A business can also stretch its accounts payable by paying liabilities and expenses on the last possible due date, to keep the money in the business bank account for as long as it can.

Another strategy is for the business to prepay expenses, such as rent or interest, when it has the cash to avoid problems arising from non-payment at a later time. Also, prepayment agreements often result in a 'better' deal.

Leasing new equipment and expensive technology will distribute this cost evenly over the term of the lease (for example, two years) or the life of the asset. Instead of using cash to purchase such assets outright, a lease will incur a much smaller and predictable monthly expense for the business.

Video 12.1 Cash flow management strategies

Review 12.1

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Which financial objective is directly tied to cash flow?
2. Which types of transaction does a cash flow statement include?
3. Define the term 'cash flow'.
4. Explain the impact on cash flow of leasing equipment compared with purchasing equipment.
5. Evaluate the benefits to cash flow of using just-in-time (JIT, described in Chapter 4) inventory control systems.
6. What period does the cash flow statement usually cover? Why does this period vary?
7. What factors would a manager need to consider when preparing a cash flow statement?
8. Suggest how a cash flow statement can be used as a planning tool and a control tool.

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Activity 12.1
Comprehension

Bush Adventures Pty Ltd runs survival holidays in the Australian bush. Although it runs 18 trips a year for groups of, on average, 12 people, it is only just breaking even. To encourage participants, the business allows adventurers to pay off their trip after their travel. An accountant has explained to the owners that their business is experiencing poor liquidity with a slow accounts receivable turnover and a greater possibility of bad debts. He fears the business may become insolvent.

Answer these questions on paper.

1 Explain the most likely reason why this business has a slow accounts receivable turnover.
2 Propose an appropriate strategy this business could use to solve its liquidity problems.

Discounts for early payments

A business may offer discounts to account customers (debtors) for early payment of their accounts to speed up cash inflow. This discount may be as little as 2 to 5 per cent; however, for large orders this amount may be significant. Other incentives for early payment could include small gifts and discounts on future orders.

The business may choose to shorten the credit terms it allows for account customers. Reducing the number of days that a customer can take to pay an invoice will speed up cash inflow into the business, as it receives cash from its credit sales sooner.

Alternatively, it may notify the account holder of changes to its credit policy and in future charge a valid late payment fee to cover its costs for account holders who exceed the account payment period, thereby encouraging payment before the due date.

Factoring

Accounts receivable represents the amounts of money owed to the business from credit sales. These accounts can be sold to a factoring business (often a finance company or bank) at a discount. The factoring firm pays the business the value of accounts receivable, less its fee or commission. Hence, its original total for current assets is now actually worth less; however, this creates an immediate cash inflow and the factoring firm collects the money from the account holders as payments fall due.

Source 12.5 A business may offer discounts to account customers (debtors) for early payment of their accounts.

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Business Bite

Factoring is very popular worldwide. It is estimated that at least $3 trillion is currently factored worldwide in a year. The largest volume being factored is in Asia, with China growing the fastest. In Australia, invoice factoring is growing and is especially important for small business. Unpaid invoices (accounts receivable) can be converted into cash within one to three days for 80–90 per cent of the total invoice owed.

The COVID-19 pandemic has created greater problems in collection of these factored accounts receivable and resulted in increased bad debts. Businesses such as CIMIC have suffered reduced strength in their financial position and credit rating. CIMIC had increased its use of factoring over the past few years and by June 2020, had a balance of $1.87 billion in factoring obligations.

12.2 Working capital management

Working capital is the current assets used to fund the day-to-day running of a business. Current assets need to be well managed so that the business always has enough liquidity to pay bills when they are due.

The business needs to manage accounts receivable to ensure it receives payment for goods (and services) provided on credit to customers and still has stock available to sell. Net working capital can be calculated using this formula:

$$\text{Net working capital} = \text{Current assets} - \text{Current liabilities}$$

Effective working capital management will mean the business's current assets will always be greater than its current liabilities. This can be assessed using the working capital ratio, which is also referred to as the liquidity ratio or current ratio. Managers need to determine the best level of working capital for their business. The formula is:

Working capital The current assets used in the day-to-day running of a business and to pay current liabilities that fall due.

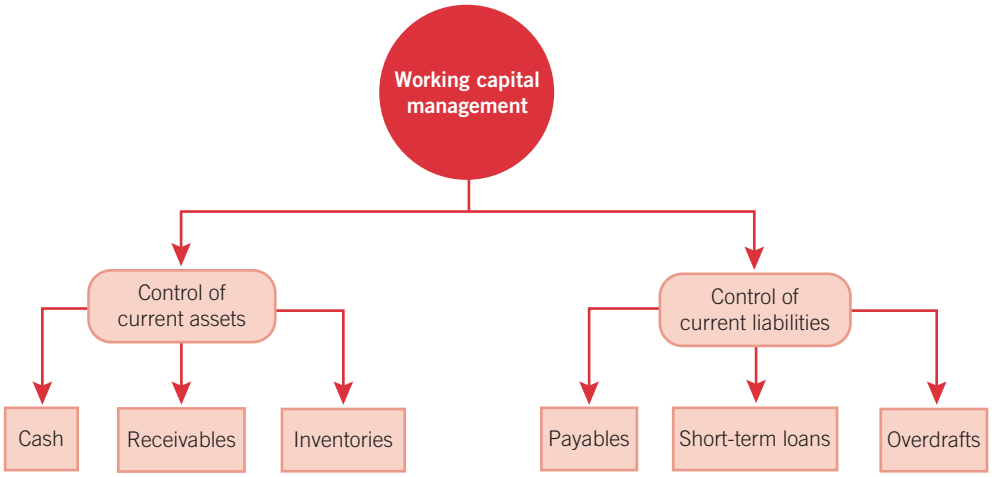
$$\text{Working capital ratio (current ratio)} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

If current assets are $69 000 and current liabilities are $46 000, then:

$$\text{Working capital ratio} = 69\,000 \div 46\,000 = 1.5{:}1$$

For every $1 of current liabilities, this business has $1.50 of current assets.

Source 12.6 Strategies in working capital management



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Results for the working capital ratio need to be greater than 1:1 for the business to be in a financially stable position. A business can manage working capital by using strategies to control current assets and current liabilities. Management strategies generally involve increasing the value of current assets and decreasing the value of current liabilities.

Control of current assets

Control of current assets involves ensuring there are enough liquid assets to pay current liabilities when they fall due. These more liquid assets can be readily converted into cash within a 12-month period. The three most common current assets are cash, accounts receivable and inventory. The role of the financial manager is to:

- develop strategies to increase the amount of cash in the business's bank account
- increase the reliability and frequency of cash inflow
- encourage anyone who owes the business money to pay as quickly as possible.

Cash

Cash is the most liquid current asset and is the balance in the business's bank account. Cash needs to be available for unexpected expenses such as the repair of vital machinery or to enable the business to take advantage of a good opportunity or purchase.

A business can increase the amount of cash it has through 'sale and leaseback'. This strategy involves the business selling non-current assets (such as equipment) to a firm that specialises in leasing assets. The advantage of leasing is that it immediately frees up capital and increases current assets. Depending on the details of the lease agreement, the business can lease the same equipment it once owned. It is also easier to budget for fixed instalments for a lease. Fixed instalments are a regular and predictable payment and will make it easier to budget for future expenses. The business needs to lease the equipment only for the time it is needed and can choose to update to the latest technology each year. The disadvantage of this strategy is that expenses are increased, as there is now a monthly lease to pay.

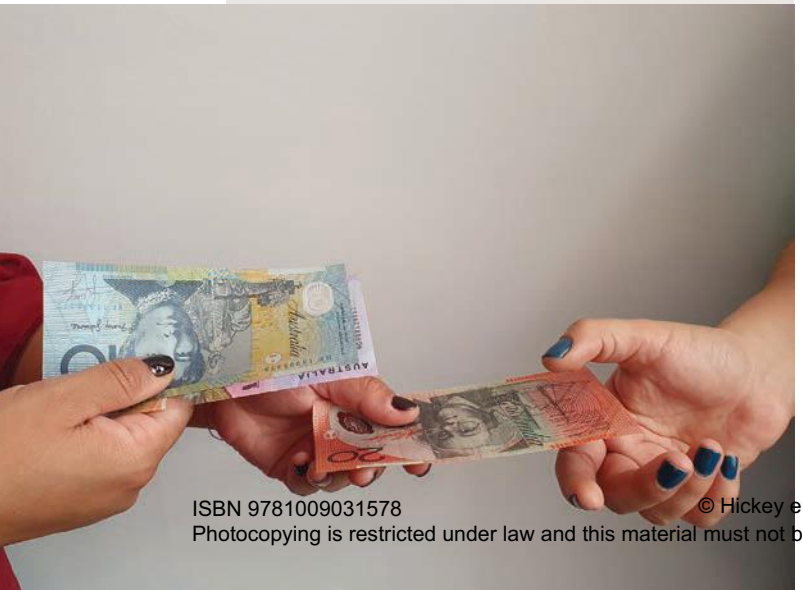
Businesses can also organise a bank overdraft before they are short of cash; interest is charged when their account is overdrawn.

In the example given in Source 12.8, current assets are $4000 and current liabilities are $2000. The calculation is 4000 ÷ 2000 = 4:2 or 2:1. The business has $2 in current assets to pay for every $1 of current liabilities, so the business has a good level of working capital.

If the business did find itself with cash flow problems, it could:

- sell its accounts receivable to a factoring company
- sell its equipment or building and lease it back to inject cash into the business. (Note: if it did sell the building, it would have to repay the mortgage attached to the property.)

Source 12.7 Cash is the most liquid form of asset.



Receivables

Receivables, or accounts receivable, is also known as debtors. The effectiveness of control over accounts receivable is measured using the accounts receivable turnover ratio. If the accounts receivable turnover ratio (total sales ÷ accounts receivable) is low, then account customers are taking far too long to pay, slowing down cash coming into the business. If the ratio equals four times per year, then the customers are taking, on average, 90 days to pay their accounts. A business may offer its account customers discounts for early payment to speed up cash inflow.

To increase cash inflow, the business may also:

- Sell its accounts receivable to a specialist factoring firm. The factoring firm will give the business cash for its accounts receivable, less a commission or fee, which it can use to cover short-term liabilities. Note that factoring will reduce the value of total current assets and make the working capital ratio worse.

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Source 12.8 Worked example of working capital ratio

	$		$
Current assets		**Current liabilities**	
Cash	1000	Bank overdraft	1500
Accounts receivable	2000	Accounts payable	500
Stock	1000	**Non-current liabilities**	
Non-current assets		Mortgage loan	50000
Equipment	10000	**Equity**	
Building	86000	Capital	48000
Total assets	**100000**	**Total liabilities + equity**	**100000**

- Introduce a late payment fee. (Unless this is specifically written into the conditions of credit, it is illegal for a business to arbitrarily impose a late payment fee.)

Another strategy is a review of the firm's credit policy by the financial manager. The manager may decide to:

- impose a credit limit on customers
- check the credit history of those who request credit
- send regular reminder notices for overdue accounts
- reduce the time account customers are allowed to pay
- refuse credit to those firms that consistently make late payments
- ask customers for a deposit on orders
- introduce cash on delivery (COD) for slow-paying customers
- offer a discount for early payment
- offer a discount for cash purchases.

There may also be a high number of **bad debts**, which happen when firms that owe the business money can no longer afford to pay. The business will need to **write off** these uncollectable accounts. These written-off accounts are then treated as an expense in the income statement, which will reduce the business's profitability.

Bad debts Debts that are unlikely to be paid. Debtors may have entered bankruptcy and are unable to pay their invoices. The business will have to reduce the value of accounts receivable in the balance sheet by writing off these debts.

Write off To eliminate an asset from the balance sheet because it has no value, such as an item of equipment that has reached the end of its useable life or perishable stock past its use-by date. Income may also be written off from a customer that is unable to pay its invoice and is therefore a bad debt.

Review 12.2

Comprehension

The following questions are based on the table below.
The credit terms offered by this business are net 30 days.

Aged debtors listing report

Account customer	Total owed	0–30 days	30–60 days	60–90 days	Over 90 days
A	$2100			$2100	
B	$120				$120
C	$14500	$14500			
D	$3520	$2950	$439	$131	
E	$3216		$3216		

Continued →

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Answer these questions on paper or in the Interactive Textbook.

1 Identify which account the business will most likely write off as a bad debt.
2 Which business should have its credit terms reviewed?
3 Outline two appropriate strategies that may be used to encourage account customer C to pay the amount owing.
4 Explain why customer A is still able to have $2100 owing after 60 days.
5 Explain what could have influenced the decisions made by customer D.
6 Which customer account would this business be most interested in maintaining? Suggest reasons for your answer.
7 Explain why an aged debtors listing report is an effective tool to monitor accounts receivable.

Inventories

Another working capital problem a business may experience is to have too much cash invested in inventory, which includes raw materials, work in progress and finished goods. The business has used cash to buy inventory (or stock) and now does not have enough cash to pay short-term debts. In addition, this stock may take a long time to sell and involves costs for storage space, insurance and monitoring. Additionally, the business may discover that it loses stock as a result of poor monitoring, inadequate security or administration errors.

Stock movement The physical movement of stock into a business when it is bought as inventory and out of a business when it is sold.

Successful businesses closely monitor and protect their inventory. Methods for internal control over inventory include:

- regular physical inspections, counts or stocktakes
- security, such as cameras and security tags to prevent theft
- suitable transportation and storage to prevent accidental damage or spoilage (for example, ensuring food is stored at the correct temperature)
- limiting staff access with locked doors and security cards
- only purchasing enough inventory to satisfy anticipated sales and providing a sufficient buffer to cover unexpected increases in demand and to avoid a run-out
- keeping accurate records of purchases, inventory received and inventory sold.

A just-in-time (JIT) inventory management system can be used to reduce the costs of storing stock. The business needs a much smaller amount of storage space, which reduces expenses and frees up cash to pay liabilities. A computerised inventory management system using barcodes to identify **stock movement** will give the business instant information about what stock it needs to order and can even contact suppliers. This strategy will also reduce stock loss due to its being mislaid, stolen or damaged. The financial manager and the marketing manager can decide to eliminate slow-selling items from the product list and change the sales mix.

Activity 12.2
Comprehension

Answer these questions on paper or in the Interactive Textbook.

1 Outline the three most common current assets that many businesses own.
2 Place your three current assets from Question 1 into order from the most liquid to the least liquid. Give reasons for their order in the list.
3 Discuss why accounts receivable is classified as a liquid asset.
4 Explain why a business needs to have more current assets than current liabilities.
5 Clarify why it is considered inefficient to have large cash reserves.
6 Justify why a business can offer discounts for early payment but cannot freely impose a late penalty fee on account customers.
7 Recommend when a business should enter into a lease agreement rather than purchasing an asset.
8 Discuss: How would the new concept of 'after pay' affect cash flow?

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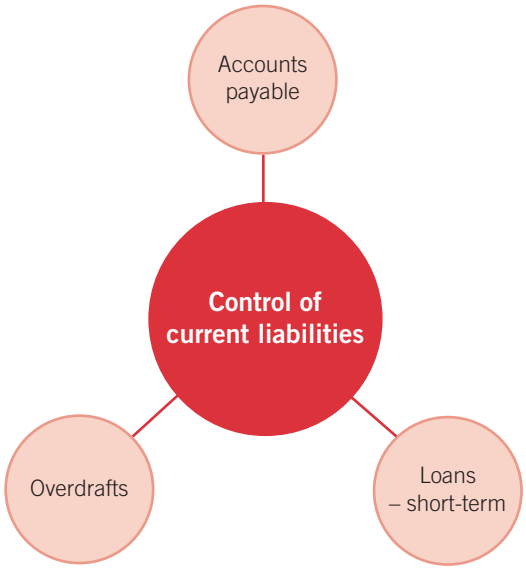
Source 12.9 Security measures help protect a business's inventory.

Control of current liabilities

Current liabilities are expenses that must be paid in the short term. The most common items include accounts payable, short-term loans and overdrafts.



Source 12.10 Current liabilities

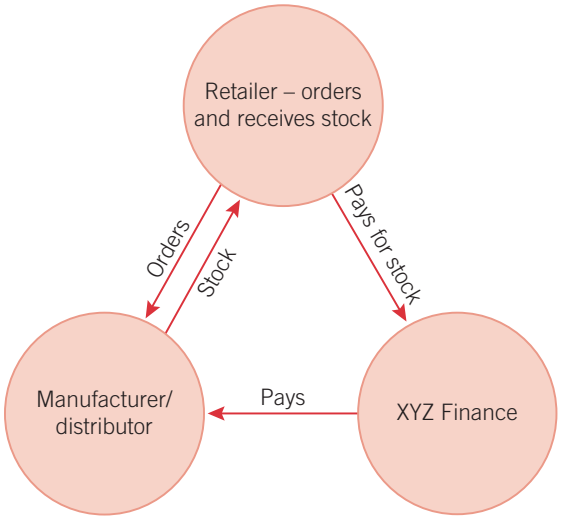
Payables

Payables, or accounts payable, is the money the business owes to its suppliers. Accounts payable is also known as creditors. A supplier will deliver goods to the business with an invoice that the supplier expects will be paid within the time allowed (that is, the interest-free trade credit period). A supplier may give seven, 14 or 30 days or longer to pay, depending on the **credit rating** the business has and the relationship it has with the supplier. However, the business may have too many bills to pay at once. More cash is going out than coming in from sales, creating a cash flow shortage.

Credit rating An assessment of a business's ability to repay loans based on its past financial performance and repayment of past loans. Credit ratings are usually expressed as letter grades, such as A–, B or C+.

Paying bills too early is an inefficient use of cash, as the business should hold on to the money and use it to pay more urgent expenses first. However, it may pay some bills early to take advantage of discounts for quick payment, offered by some creditors. If the business pays its invoices too late, then it risks its reputation with its suppliers. The supplier may no longer offer a discount, may shorten the credit period or may refuse to supply in the future. A strategy to control payables while keeping a good reputation and credit rating with its suppliers and avoiding penalties is to stretch accounts payable (that is, to pay its invoices on the last day they are due). In this way, the business can keep as much cash in the business as possible to pay more urgent liabilities. A business should not simply focus on the cheapest supplier, but should take into account the trade credit terms offered.

Businesses may also use floor plan funding for inventory through a finance company, or even acquire inventory on consignment, where the supplier retains ownership of the inventory and is paid when an item is sold.



Source 12.11 Floor plan funding

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Loans

The business must compare the costs and term of the loan with other sources of finance, such as leasing, in order to use the most appropriate form of finance for short-term needs.

Short-term loans, although more expensive than long-term loans, may be helpful for businesses with seasonal variations in demand or that need to even out cash flow. Businesses need to make loan repayments on time, as continued late payments may create issues for future access to debt finance.

Source 12.12 Online banking systems give financial managers access to the business's bank accounts at all times.

Many financial institutions offer short-term loans to businesses for amounts up to $100000 and repayable over three months. However, increasingly, businesses are using a business credit card. These business credit cards are available from major banks and often have the advantage of up to 55 days interest free on purchases. Interest rates vary from 10 per cent to 21 per cent and incur an annual fee, depending on the benefits attached to the card and if security has been provided.

Overdrafts

Overdrafts are intended as a short-term source of finance and should be used to fund short-term cash shortages.

A business can control its overdraft by ensuring that all cash received is promptly deposited in the business's overdraft account to reduce the amount owing. Online banking systems give financial managers access to the business's bank accounts 24 hours a day, seven days a week.

Strategies

Leasing

Leasing is a method of obtaining the use of an asset in return for a series of payments over a set period of time as set out in the leasing contract. Acquiring the asset will not use up cash available, as there is no deposit required and the expense will be spread over a longer period. It is common to lease equipment such as computers, office

Scenario – George and Aida

George and Aida are a young couple with two small children. George has a plumbing business that has recently felt pressure from additional competition in the area. The family's income has decreased and they are having trouble paying their bills and mortgage. George and Aida have no cash available and are using their credit cards to keep up with the bills. George feels that work is slowly improving; however, he realises it may not be soon enough. Following financial advice, they are considering seeing their credit providers to tell them of their predicament and to discuss taking some of the following measures:

- adjusting the terms in their loan contract to meet their current situation
- extending their loan period
- allowing them to make smaller payments over a longer period of time
- postponing payments for an agreed period.

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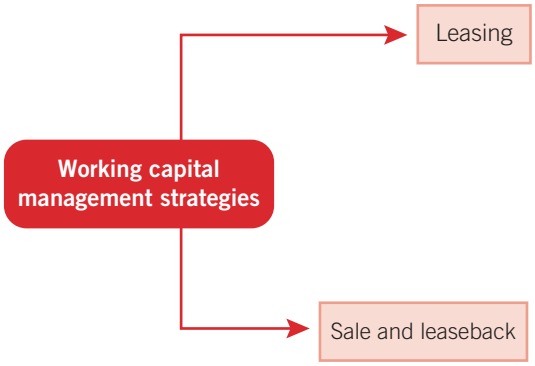
furniture and vehicles. Additionally, the lease payments will be an expense and are therefore tax deductible. Another advantage is that the leaser company organises regular maintenance and any repairs so that the business does not have to worry about these.

Sale and leaseback

Selling a non-current asset owned by the business will provide a cash injection to the business, thus making funds available to pay expenses as they fall due. The business can enter into a sales agreement that allows it to lease back the equipment or premises and make monthly payments to the new owner.



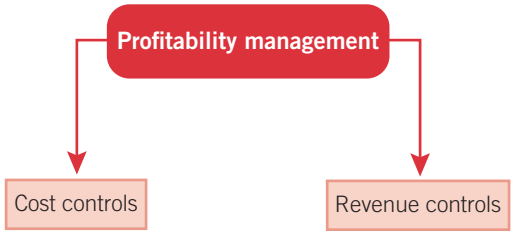
Source 12.13 Strategies for working capital management

Source 12.14 Vehicles used for business are frequently leased.

12.3 Profitability management

Profitability refers to the degree of financial success of a business. In order to assess how profitable a business is, the financial manager will need to keep an accurate and up-to-date record of all the expenses and revenues flowing from business transactions. Management must ensure that the business's accounting and financial system has effective controls in place so that it:

- does not overspend and in fact minimises costs
- maintains financial records and records transactions correctly
- maximises revenue.



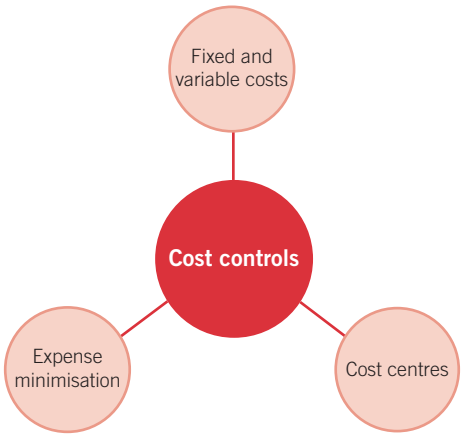
Source 12.15 Controls in profitability management

Cost controls

Fixed and variable costs

A business can increase profits by cutting costs. Businesses can reduce costs in two areas: labour and inputs. Outsourcing of non-core functions has been the most popular method of reducing costs by larger organisations. Examples of outsourcing are contracting a call centre to handle customer enquiries or hiring a specialist firm to handle payroll, cleaning, security or marketing. These organisations are aiming to achieve greater efficiency, which will allow them to focus on their core business. Costs may be classified as either fixed or variable. **Fixed costs** do not change when a business produces more goods or if it sells more goods and services.

Fixed costs Costs that do not change when a business varies the amount of goods and services it produces. Rent is an example of a fixed cost.



Source 12.16 Different cost controls

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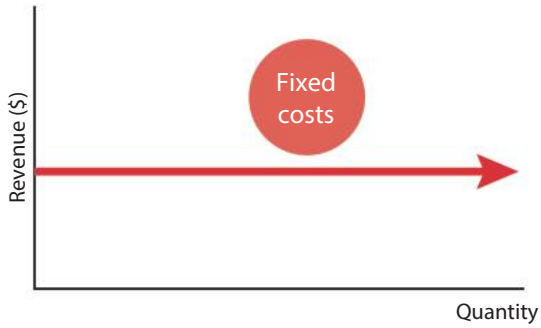
Examples of fixed costs are management salaries, rent, lease payments, fixed-interest payments on loans, **insurance premiums**, rates and government fees. Fixed costs are often contract-based and negotiated before production and sales have begun; hence, they are harder to reduce and must be paid.



Source 12.17 Fixed costs

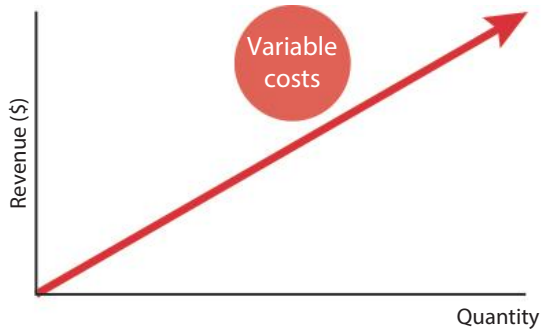
Insurance premium The cost of obtaining insurance. The premium is based on the risk of the insured event actually occurring.

Variable costs Costs that change when a business varies the amount of goods and services it produces. For example, the more a business produces, the more raw materials it will need. The cost of raw materials is an example of a variable cost.

On-costs The additional costs to a business of employing staff. As well as paying a wage or salary, a business must pay staff leave for sickness, holidays and maternity leave. A business must also contribute to the retirement savings of employees by paying superannuation. These are legal requirements.

Variable costs do vary as output and sales change. Examples are employee wages and overtime payments, advertising, cost of purchasing inputs, raw materials, electricity, phone, warehouse storage costs and the cost of transporting materials.

Management's control of costs will focus on variable costs, as there is more flexibility to change these. In each case, managers will want to eliminate waste



Source 12.18 Variable costs

(where an expense does not add value to the product or service the business provides).

Strategies to cut variable costs include:

- negotiating discounts with all suppliers (for example, through bulk ordering stationery supplies)
- reducing the number of suppliers and negotiating contracts for discounts (otherwise called supplier rationalisation)
- switching to a cheaper supplier
- reducing the number of sales staff and multiskilling remaining staff
- increasing self-servicing by customers (for example, by installing automatic teller machines and self-serve registers) and reducing the number of staff employed
- sharing the cost of resources with other businesses, such as delivery costs
- replacing full-time permanent staff with casual staff because no **on-costs** (such as holidays and sick leave) need to be paid to casual staff
- using JIT inventory management.

Fixed and variable costs will need to be compared to those of past time periods, what

Source 12.19 Examples of fixed costs, variable costs and on-costs of labour

Fixed costs	Variable costs	On-costs
Loan repayments Insurance Lease payments Salaries Rent	Electricity and gas Phones Raw materials Stationery Piece-rate labour commissions Credit card fees Freight/delivery charges Petrol Costs of goods sold	Superannuation Annual leave Allowable family and community services/sick leave Payroll tax Public holidays Workers compensation insurance Annual leave loading Casual loading Maternity leave

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was forecasted in the budget and what the actual figures were. They can also be compared to industry averages.

Cost centres

Cost centres are set up for divisions or departments within a business to account for the expenses/costs involved in the function they perform, such as research and development. Cost centres do not produce a direct profit, and they add to the cost of running a business.

Management may provide the cost centres with a budget and monitor their expenses to minimise waste and achieve maximum use of resources. For every good sold there are operations expenses involved in making and supplying, financial expenses (such as interest on loans to buy machinery and supplies), marketing expenses, administration expenses and human resource expenses. A financial manager can take the total cost of making and supplying a good and calculate the percentage contribution of each cost centre. Cost centres contribute to profit indirectly and are often the target for downsizing and outsourcing. Thus managers are responsible for ensuring that costs are kept in line and often below budget. Some businesses have made their managers' bonus system dependent on the manager being able to keep within or decrease spending in their budget.

Expense minimisation

Cost centres can be used to identify which type of expense contributes most to the product. This would be the area where any expense minimisation would have the greatest effect.

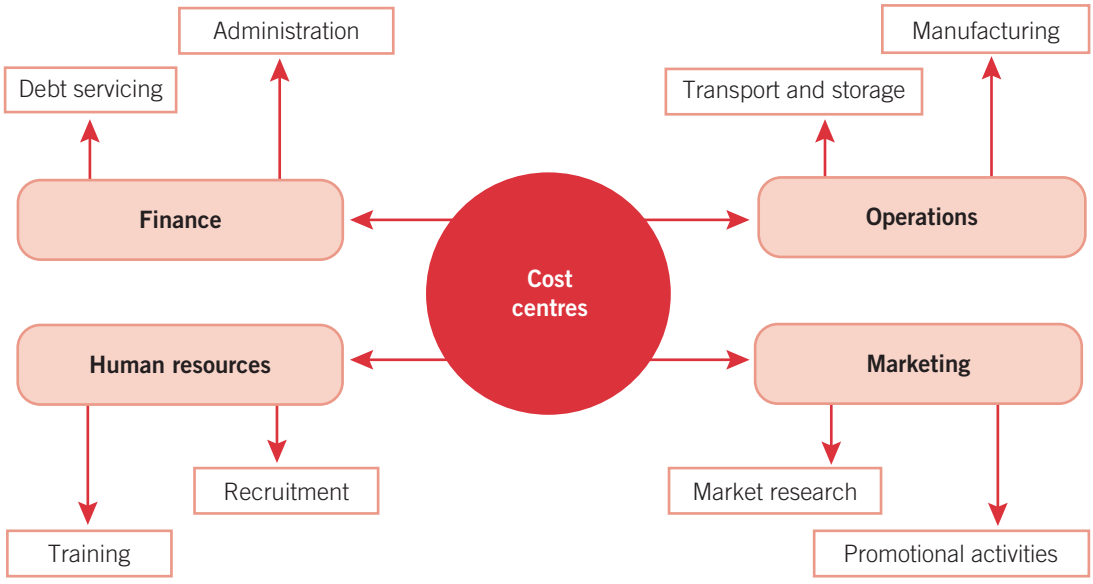
Cost centres use budgets as tools to evaluate the performance of a business by comparing actual amounts spent to the planned figures for both fixed and variable costs. Since most fixed costs cannot be changed, variable costs will usually be targeted for expense minimisation to eliminate unnecessary costs while maintaining the same quality and output with fewer resources.

For example, businesses could:

- decrease the costs of packaging their products
- introduce a JIT inventory management system to reduce costs such as warehousing
- increase the efficiency of the workforce through multiskilling
- substitute machinery for labour
- downsize middle management.

Budgets can also be used to identify which expense contributes the most to cash flow problems so that specific strategies can be developed to deal with the expense.

Cost centres Centres that account for the expenses/costs incurred by each key business function (that is, operations, marketing, finance and human resources) in providing a product to consumers.



Source 12.20 Examples of individual cost centres within departments

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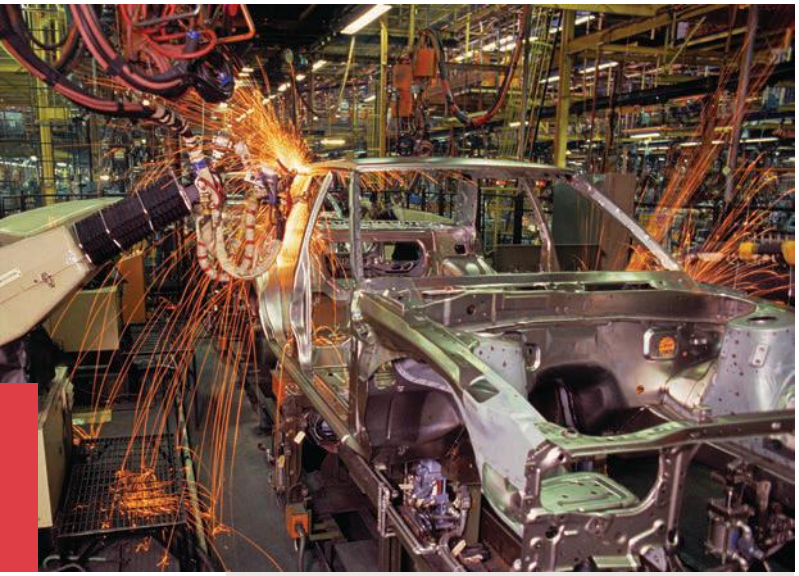


Source 12.21 Some businesses have minimised their expenses by replacing some staff with machinery, such as in the automotive industry.

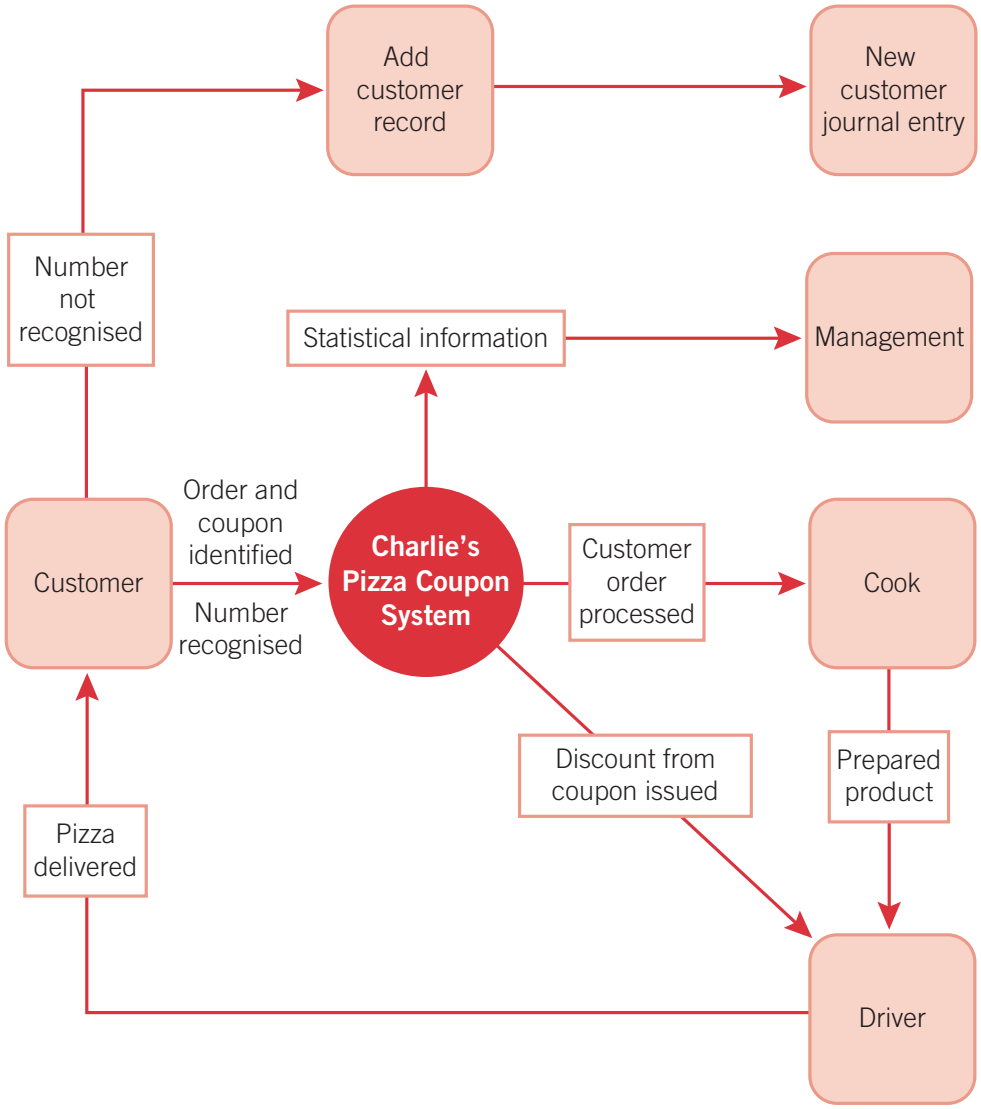
In expense budgets, management puts a limit on what may be spent on certain expenses in individual cost centres (for example, the number of colours used in a textbook).

Expense minimisation will reduce cash outflow, especially where there are specific policies to deal with managers and employees who overspend.

Revenue controls

Revenue is the money that a business receives during a specific time period from its business activities, such as sales, fees and commissions. It must take into account discounts and returned sales items. The flow of revenue and the use of a discount coupon system for a pizza business are shown in Source 12.22.

Source 12.22 Flow of products and money for Charlie's Pizza Coupon System



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Marketing objectives

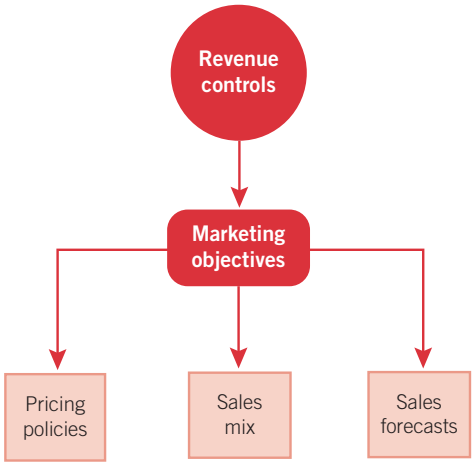
On the whole, marketing objectives and strategies aim for increased sales and therefore increased revenue for the business. Revenue controls can be used to achieve marketing objectives. Revenue controls include **sales forecasts**, analysing the **sales mix** and the pricing policy of a business. Budgets can be applied to sales forecasts. A sales budget is used to predict future sales of the business based on:

- patterns of sales in previous years
- performance of marketing strategies
- economic conditions
- level of competition
- stage in the product's life cycle
- market research.

Businesses will have short-term sales objectives. The actual level of sales can be compared to what was budgeted each month, week or even day to determine whether the business is on track to

Sales forecast The predicted future sales a business expects to make during the year considering the business's internal and external environments.

Sales mix The combination of different products and services that make up the total sales of a business.



Source 12.23 Revenue controls can be used to achieve marketing objectives.

Business Bite

Some businesses change product size or recipe for, among other reasons, to modernise or make a healthier product. Sometimes the target market does not like the change. What do you think about the following examples?

- Arnott's Pizza Shapes – after 40 years, Arnott's brought out a new flavour with an improved health star rating, but after severe consumer backlash it was forced to resupply the old recipe.
- Tiny Teddies and Shapes in multi-packs have gone from 10 to 8 in a pack in 2017 while still at the same price.
- BBQ Shapes packets decreased in size from 200 grams to 175 grams. However, the price remained the same. This represents a price increase of 12.5 per cent.
- Magnum ice creams shrank from 117 millimetres to 107 millilitres in 2017 while still at the same price.
- Nescafé – new Café Menu range.
- Allen's – took the artificial colouring out of its Snakes (now blue is purple); removed Spearmint Leaves, Green Frogs and Polly Waffles from its mix; reduced the size of Killer Pythons from 47 grams to 24 grams.
- Cadbury – changed the recipe of the chocolate for its 39-gram Creme Egg; reduced the size of its family block by four pieces, which was a decrease from 220 grams to 200 grams, in 2009. Cadbury returned to the original size in 2013, only to decrease it again in 2015!
- Coca-Cola's New Coke – reverted to its original recipe.
- Terry's Chocolate Orange – segments are now hollow and not solid.
- Tim Tams – kept the classic but introduced 'limited edition' varieties.
- Toblerone – fewer triangles per bar, with 170-gram bars reduced to 150 grams and the larger bar reduced from 400 grams to 360 grams.

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reach its sales objectives. Sales reports can provide a lot of information for the financial manager. The sales objectives, therefore, link the marketing plan to the financial plan, as increased sales translate into increased revenue.

Sales mix is the combination of the different products and services (the firm's product range) that make up the total sales of a business. Marketing strategies are used to sell the range of products that a business supplies. A sales report can be used to identify which method of promotion works best (that is, which is the most efficient and effective). From the report, the financial manager can also identify which products contribute most or least to total revenue and therefore identify which products to concentrate on and which to eliminate from the product range, while keeping in mind the business's target market research.

Review 12.3

Analysis

Examine the sales report below and answer the questions.

Sales report for Insnow Pty Ltd

	July		August		September	
	Budget	**Actual**	**Budget**	**Actual**	**Budget**	**Actual**
Sales by Sarah						
Skis	6000	5800	5000	4700	4000	2800
Accessories	3000	2700	3000	1200	2000	1700
Snowboards	2000	1300	2000	1400	1500	1300
Sales by Harry						
Skis	6000	6200	5000	6300	4000	5100
Accessories	3000	2900	3000	3100	2000	3000
Snowboards	2000	1100	2000	1300	1500	1100

Answer these questions on paper or in the Interactive Textbook.

1. Which salesperson, Sarah or Harry, is not meeting their sales objective?
2. Which product would you delete from the product range?
3. Which product would you increase the display space for? Justify your selection.

A pricing strategy to control revenue is to use a cost-based pricing method whereby the price is based on what the good costs to supply. In this method, there is a set percentage mark-up on each item sold to ensure the business receives a certain amount of profit on each sale and meets its profitability objectives. A price for each product will need to be determined that will ensure that market share is maintained or even improved. A business may choose to reduce or discount the price of products that are not selling well. This may increase total sales. However, because the price is lower and the profit margin on each good is smaller, the business may not experience an increase in total revenue or profitability. The business would have to sell a much higher volume of goods at the discounted price to increase total revenue.

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Activity 12.3
Comprehension

Answer these questions on paper.

1 Discuss the difference between cash flow and working capital.
2 Draw a graph illustrating fixed costs and variable costs. Then add a 'total cost' curve. (Hint: total cost = fixed cost + variable cost.)
3 Define cost centres.
4 Recall why cost centres are useful for profitability management.
5 Identify how a budget can be used as a cost control tool.
6 Explain the advantages to the business of discounts offered for early payment of accounts receivable.
7 Analyse why discounting to sell stock quickly may not improve cash inflow.

12.4 Global financial management

When a business becomes part of the global economy, it is open to additional influences from the external environment worldwide. Expansion into the global marketplace has made business more complicated and risky. Global financial variables are an additional risk that must be managed.

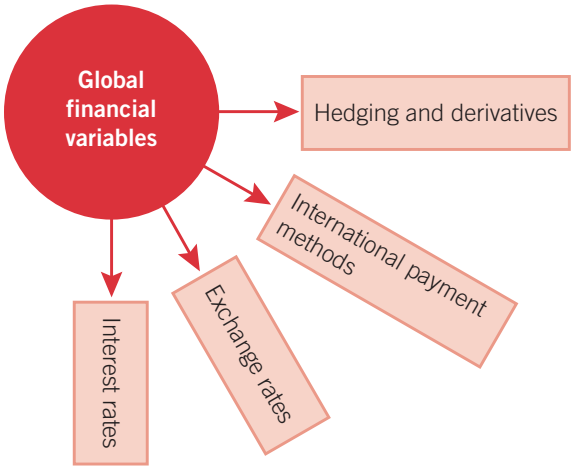
Exchange rates

Each day the value of the Australian dollar (AUD) changes according to the performance of the Australian economy, as well as other economies. Currency fluctuations are changes in the **exchange rate**. It involves calculating how much is received when the AUD is swapped for the currency of another country. This exchange takes place on the foreign exchange market (forex) and is determined by the supply and demand of the various currencies being traded.

Tourists calculate how much money they have to spend based on the currency of the country they are visiting. Businesses that sell or buy goods and services overseas will also closely monitor the value of the AUD. Currency fluctuations are a significant influence on the profitability and financial stability of global businesses. A global business transfers its costs and revenues between different countries, so the value of its net profit can increase or decrease due to the exchange rate. Source 12.25 illustrates the changing value of the AUD in relation to the **euro** (the currency of the European Union), the US dollar (USD) and the Japanese yen.

Exchange rate The value of a country's money calculated in terms of another country's money.

Euro The currency of the European Union. It was introduced in 1999, with notes and coins in circulation in 2002.



Source 12.24 Global financial variables must be managed.

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Source 12.25 Comparison of value of AUD with USD, euro and Japanese yen, 1980–2020

Year	AUD1 buys USD	AUD1 buys euro	AUD1 buys yen
	(monthly average)	(monthly average)	(monthly average)
1980	1.0831	Not yet introduced	270.13
1990	0.7542	Not yet introduced	118.79
2000	0.6055	0.6317	63.77
2001	0.489	0.5559	60.96
2002	0.5316	0.6086	70.53
2003	0.6036	0.5576	71.97
2004	0.7589	0.6203	79.08
2005	0.7719	0.5973	82.69
2006	0.7382	0.5889	84.05
2007	0.807	0.6049	94.94
2008	0.918	0.5813	91.58
2009	0.6873	0.519	67.48
2010	0.912	0.6716	82.58
2011	1.0060	0.7172	81.91
2012	1.0552	0.8012	87.13
2013	1.0346	0.7979	98.17
2014	0.9071	0.6561	92.81
2015	0.7634	0.707	91.72
2016	0.7657	0.677	85.93
2017	0.7605	0.7151	86.96
2018	0.7758	0.6292	82.26
2019	0.7081	0.6264	78.75
2020	0.6353	0.5620	66.71
The values are the averages for the month of March			

Source: Reserve Bank of Australia.

The value of the AUD depreciated significantly against the currencies of Australia's major trading partners from 1980 until 2001. This made imported goods coming to Australia relatively more expensive and the prices of Australian exports in foreign markets relatively cheaper. Businesses must plan for the value of the AUD being quite volatile. For instance, after appreciating (increasing in value) since 2002 and peaking at US 96 cents during June 2008, the value of the AUD depreciated steadily from July 2008 until January 2009, and then generally appreciated again, reaching USD1.05 in 2012. Since then, the value has decreased and was at US 72 cents in August 2020.

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Activity 12.4
Research

Answer these questions on paper.

1 Investigate the changes in exchange rates for another country of your own choosing. There are many websites, such as the Reserve Bank of Australia (RBA) and the OANDA websites, that can provide historical data.
2 Research some reasons why the exchange rates that apply to the Australian economy change. These may include speculation, recession, inflation, high interest rates, GFC and other global factors. Try to tie the event/factor to a time period in the table in Source 12.25.

If an Australian company is exporting its product around the world, it will want to be paid in AUD. How much it will be paid is uncertain, because the value of the currency changes all the time. Similarly, an Australian business that imports parts or components will need to pay its suppliers in the currency they request, such as USD or Japanese yen. Currency fluctuations will affect the business's ability to meet its revenue and cost objectives and therefore its profit targets. Financial managers spend a lot of time developing detailed budgets to allow accurate planning. Uncertainty created by fluctuating exchange rates can make these budgets useless and unacceptable for business planning.

When the AUD appreciates, it is worth more when converted to other currencies. The result of any **appreciation** is that imported goods become cheaper. It costs the Australian business less to pay a US business in USD. If the cost of imported inputs falls, it is possible for the Australian business to produce and supply the same amount of goods at a lower price.

However, Australian goods exported overseas become more expensive compared with what they were previously. This reduces the international competitiveness of the Australian business. Higher prices will mean that sales will fall as US consumers substitute the Australian product with a cheaper one from another country or one that is made in the United States.

If the AUD is depreciating, or losing value, Australian businesses that export goods and services will find that sales will increase as their goods and services are now cheaper and they may receive more revenue. Australian businesses that import goods and services will have to pay more. The importer may pass on these costs to consumers as higher prices. This will make Australian businesses more competitive on the international market.

Source 12.26 Exchange rates can be a risk to businesses.

However, the importer may reduce its orders, as it costs more AUD to buy the same amount of foreign currency to pay the supplier. The goods have become more expensive. Increased financial risk is likely from unfavourable currency changes that increase expenses and erode profits.

Appreciation An upward movement or increase in value of the Australian dollar compared to any other currency.

A business will need to use strategies such as hedging to eliminate the effects of currency fluctuations on the amount it receives or pays.

Interest rates

A global business can borrow money from financial markets in other countries. A business will borrow from the country with the lowest interest rate.

However, there is an exchange rate risk for the business. If the value of the home country's money depreciates, then interest repayments increase because it costs more AUD to obtain the same amount of foreign currency to pay the interest and repay the loan. Transaction exposure refers to the risk that exchange rates may change after the business has already entered into financial obligations.

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Overseas borrowing has a number of advantages over borrowing locally:

- The rate of interest can be cheaper.
- Appreciation of currency makes interest repayments cheaper.
- There are not as many restrictions on matters such as the amount that can be borrowed, the period for repayments or the loan conditions.
- Finance may be acquired more quickly and easily.
- Improved banking industry technology and improved information are available.
- International monetary transfers and deregulation of the Australian banking system have made foreign currency loans more easily available to Australian businesses.

The Australian business will need to thoroughly research overseas economies, foreign government policies and political stability to assess the financial risk to the business of interest rate rises.

Overseas interest rates in the economies of Australia's trading partners (such as the United States and China) may also influence Australia's domestic interest rates.

Business Bite

Source 12.27 Who owns us now?

Logo/Brand	Began in Australia	Sold	To overseas country	New owner
Speedo	1914	1990s	British based	Pentland Group
R.M. Williams	1932	2013 and 2014	Asia	L Capital Asia
Uncle Tobys	1893	2006	Swiss	Nestlé
Arnott's Biscuits	1865	1999	United States	Campbell Soup Company
Bundaberg Sugar	1880s	2011	Belgian	Société Financière des Sucres
Streets	1930s	1959	British/Dutch	Unilever
Peters	1907	2014	European	R & R Ice Cream
Billabong	1973	2012	United States	Private Equity Group
Cottee's	1920s	2009	Japan	Asahi Breweries Ltd
Schweppes	1877	2009	Japan	Asahi Breweries Ltd
Bellamy's Organic	2003	2019	China	Mengniu Dairy

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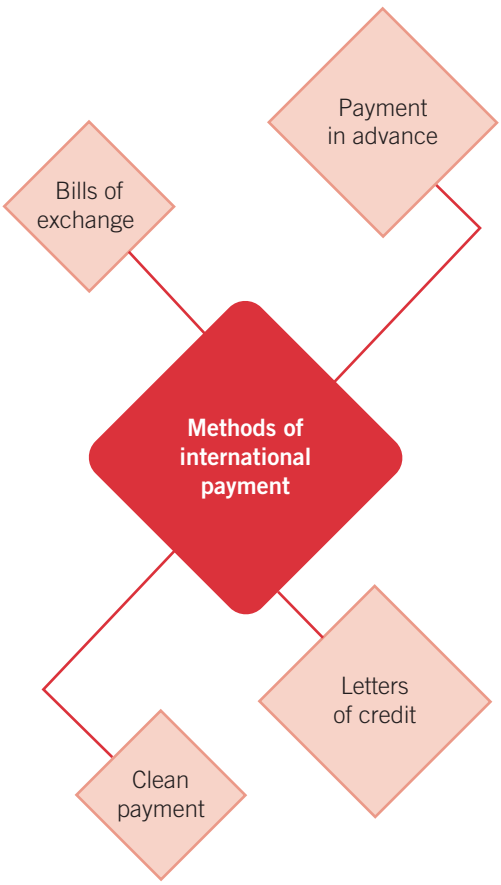
Activity 12.5
Comprehension

Answer these questions on paper.

1 Identify which currencies are currently the most popular for trading internationally.
2 Discuss whether a country always trades in its own currency.
3 Identify currencies that a trading country may not want to trade in at present. Justify your response.
4 Explain why currencies of different countries are most often compared with the US dollar.
5 Describe the advantages for an Australian business of acquiring finance from foreign financial markets rather than from the Australian market.
6 Explain how a business can at first benefit from acquiring cheaper debt finance from overseas and then lose the benefit of cheaper finance owing to exchange rate changes.
7 Rusty is a supplier of kangaroo meat. He has successfully penetrated the US market by selling his Australian products in the United States. If there is a depreciation of the Australian dollar relative to the US dollar, describe how this will affect Rusty's revenue.

Methods of international payment

An importer will want to minimise costs, make payment as late as possible and have the goods before paying for them. On the other hand, an exporter will want the highest price for its goods, to be paid quickly and to try to keep control of the goods until they are paid for. There are many methods of payment used by global financial managers for the export and import of goods and services.



Source 12.28 The main methods of international payment

Payment in advance

The most secure method of payment, where the exporter bears the least risk, is for the exporter to receive **payment in advance**. However, this will be the least desired option for the importer, as it has all the risk of the goods never being sent.

Payment in advance Method of payment in which the goods are actually paid for before they are supplied.

Letter of credit

A favoured transaction method to ensure payment from an importer is to require the importer to have a letter of credit. A letter of credit is a document issued by the importer's bank to the seller/exporter of goods, promising to pay the exporter on presentation of the shipment documentation. The exporter may also require partial payment for the goods in advance. This strategy carries a lower amount of risk for the exporter.

Bill of exchange

An exporter and importer may agree to use a bill of exchange and an international bank as an intermediary in the transaction. A bill of exchange is a written order from a seller requesting that an importer or buyer pay the seller a specified amount of money at a specified time. The bank,

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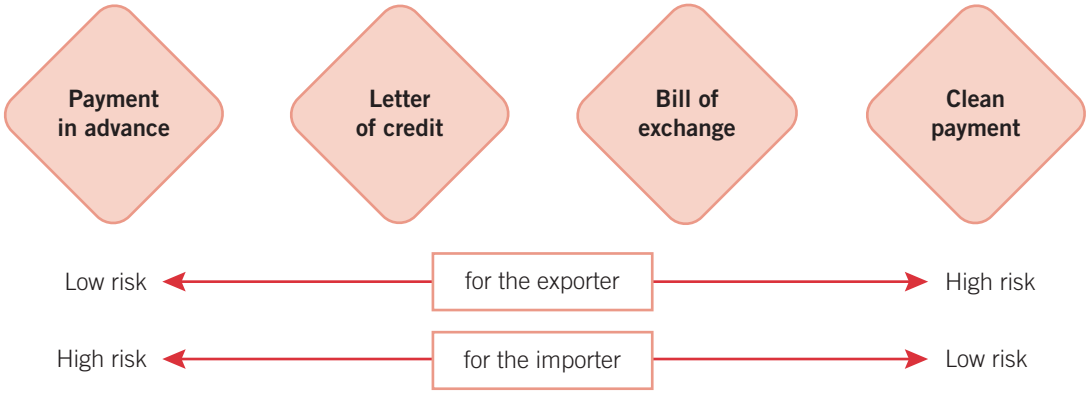

Source 12.29 Level of risk of payment methods

acting as a negotiating intermediary, ensures that the importer receives its goods and that the exporter is paid. When the exporter arranges for the physical transport of the goods, it will receive official shipping documents, such as a commercial invoice or packing slip. Once these documents are presented to the bank by the exporter, the bank will arrange for payment to be made. After payment, a bill of lading will then be given to the importer by the exporter, giving the importer legal ownership of the goods when they arrive.

Source 12.30 A bill of lading is sent to the importer by the exporter after payment has been received. This gives the importer legal ownership of the goods.

Clean payment

The arrangement with the most risk is for the exporter to trust the buyer/importer and run an open account or clean payment. The goods are shipped before payment is received. All documentation is handled directly between the trading companies. This method should only be used when there has been a long track record of promptly paid transactions and a high level of trust.

A global business should research businesses that are purchasing, importing and distributing its products. In Australia, expert advice concerning credit ratings and the ability of some overseas businesses to pay for their imports is available from Austrade. An effective strategy to reduce the risk of non-payment for exported goods is to track export payments and shipping through each distribution channel. Exporters can take out insurance to protect themselves from non-payment by customers, the goods not arriving at their destination, damage during transit and theft.

It is also possible to insure against an unfavourable change in exchange rates affecting the Australian exporter. The Australian Government also offers insurance and assistance to Australian exporters developing new markets in more risky parts of the world that a private insurance company would not cover.

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Hedging

When a tourist exchanges their currency for the currency of their destination, the exchange is completed at a 'spot rate'. This is the exchange rate on the particular day that the money is changed over. This also happens when a credit card is used overseas. Business transactions do not take place immediately and it may take time to organise the sale of products or purchase of inputs from overseas.

Global businesses can use **hedging** to minimise the risks from exchange rate changes. Global businesses enter into contracts to buy and sell foreign exchange to purchase inputs from businesses in other countries. The exchange rate can change significantly between the time a purchase contract is signed and the time payment is made. In addition, when profits are transferred from the nation in which they were earned to the headquarters of the global business, the currency will need to be converted.

Unfavourable changes in the value of a country's currency can effectively increase costs and reduce profits. This is called **transaction exposure**. Hedging can be used to eliminate transaction exposure. Hedging can be done naturally by using subsidiaries.

Hedging using **subsidiaries** involves a global business avoiding changing between currencies by having all transactions between its subsidiaries occur in the same currency. A subsidiary is a business that is partly or completely owned by another company. For example, a toy manu-facturer in the United States may own an electronics company in Malaysia. The electronics company exports parts to be put into the manufacturer's toys. Transactions are always in US dollars to reduce currency exchange risk.

Hedging Any strategy or financial tool used to reduce the risk of loss resulting from financial transactions, such as converting one currency to another.

Transaction exposure The risk that exchange rates will change after companies have entered into an international financial contract, which could lead to increased costs and reduced profits for the business.

Subsidiary A business that is partly or completely owned by another company.

Business Bite

Since 2000, the global financial market has seen volatility in commodity prices and exchange rates. For businesses that rely on vast quantities of oil, such as airlines, this translates into unpredictable costs in their operations. An airline may respond by using hedging. This involves the use of options, swaps and forward contracts, which will allow an airline to lock in a specific price. If an airline has locked in a price through hedging, it cannot take advantage of favourable movements, but competitors can. However, the airline now has a specific price on which to base its future planning. Hedging is not always a benefit. In 2008–09, Cathay Pacific lost US$974 million and Air China lost US$944 million due to hedging. After this, the Chinese Government banned all of its airlines from fuel hedging. In 2014, Delta Air Lines lost US$1.4 billion. Many companies stopped hedging so that they could be more flexible in their pricing strategies. In Australia, both Qantas and Virgin use hedging.

Apple, the iPhone maker, has its base in California and generates 65 per cent of its revenue outside the United States, including about 25 per cent from China alone. Apple's finance department uses a comprehensive currency hedging program to protect itself from the uncertainty of future cash flows, especially when the US exchange rate is rising. Its currency hedging contracts vary from three months to 12 months in time, and by the end of 2014 were valued at US$3.5 billion. Apple made gains of US$3.5 billion from its hedges in 2015, losses in 2016 and a US$1.3 billion gain in 2017. With the recent threat of a trade war between the United States and China and threats of US tariff protection and China imposing an additional 25 per cent levy on US imports, hedging could be an effective method for alleviating (however, not fully eliminating) exchange rate risk.

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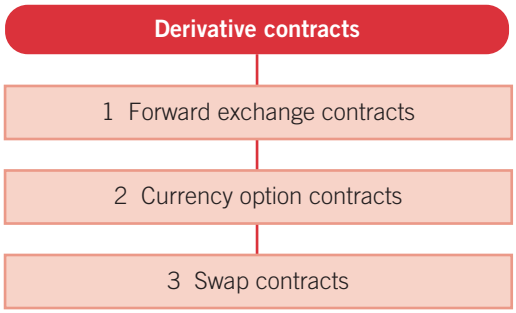
Derivatives

A very common form of hedging is to use a **derivative**. There are many different types of derivatives. However, most derivatives are financial contracts that allow one of the parties to buy something from the other (for example, petrol) for a price agreed between the parties when they enter into the contract. The petrol is then delivered at a future point in time (for example, in six months' time). This is different from a normal contract because it allows the party buying the petrol to 'lock in' the price, even though the cost of petrol may be much more expensive or much cheaper in six months' time. Derivatives therefore allow businesses to hedge against the risk that the price of items they need will change dramatically in the future.

Derivative A contract under which the buyer agrees to purchase something from the seller for a set price at a future point in time. It can be used to hedge (that is, reduce) financial risks, such as those created by the appreciation and depreciation of currencies.

A common use of derivatives is to reduce currency risk between global businesses and suppliers. The main types of derivatives are shown in Source 12.31.

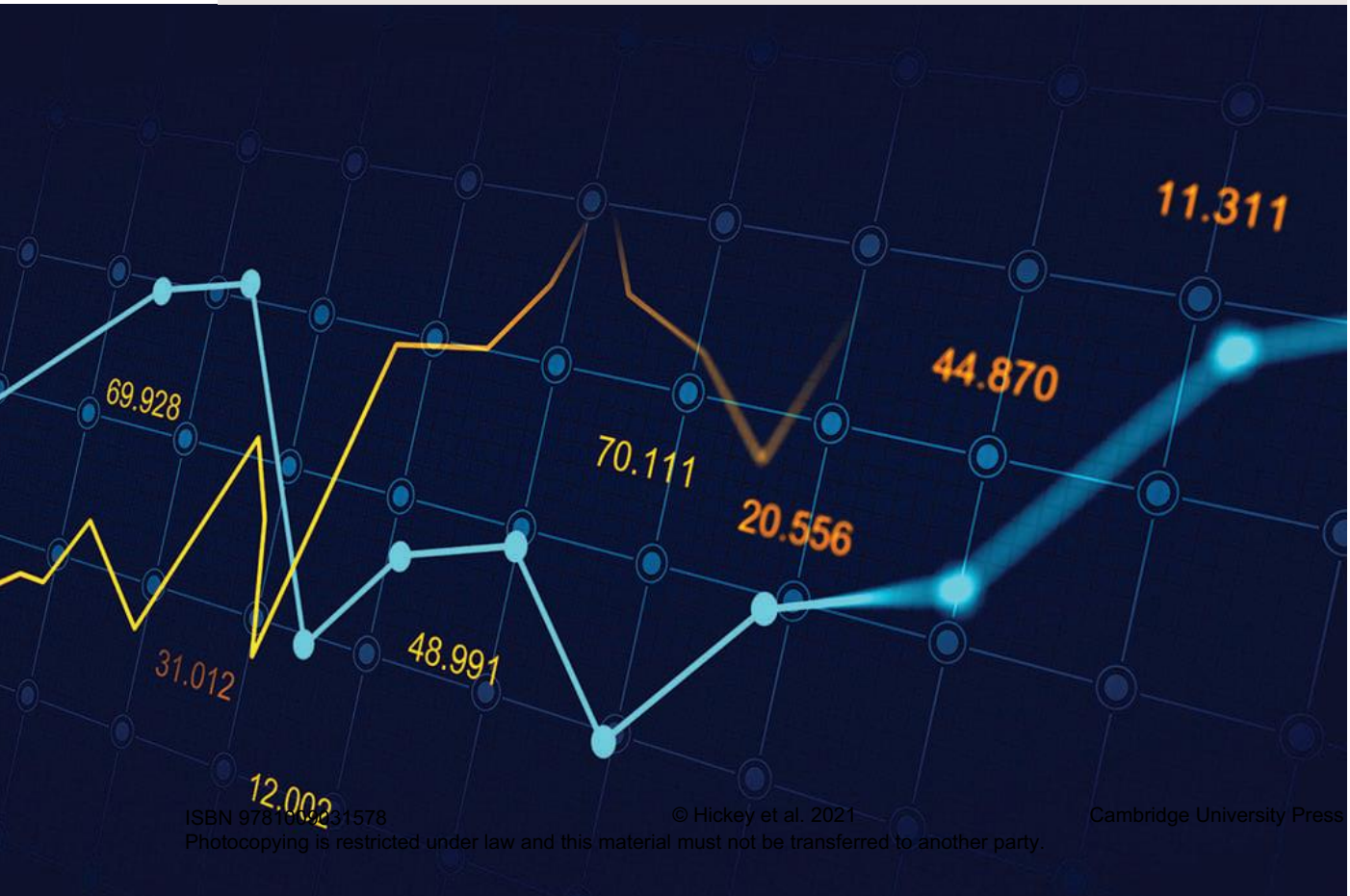
By using a forward exchange contract, the bank will guarantee the exporter an agreed exchange rate on a certain date in the future. The exporter will be able to make an accurate forecast of its revenue from the sale of the exported goods and the importer will be able to make an accurate costing. This rate will be paid regardless of what the exchange rate actually is on the agreed date.



Source 12.31 The three main types of derivative contracts

If a business purchases a currency option contract, it has the option (the right to buy if it chooses) to buy or sell foreign currency when the exchange rate movement is to its advantage. This will protect the option holder from unfavourable movements and allow them to benefit from favourable movements in the exchange rate.

Source 12.32 A currency option contract protects businesses from unfavourable movements in global financial rates and allows them to benefit from favourable movements in the exchange rate.



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A swap contract allows two businesses to use an exchange rate on a particular date in the future. This rate is called the spot rate. It is the price at which a currency can be purchased or sold for delivery in two business days. For example, an Australian business must pay its US supplier in USD. However, it has a shortage of USD, but plenty of euros to make the payment. A swap contract is written allowing the Australian business to pay the US supplier in euros at a spot rate. At a later specified date, the US business and the Australian business swap the euros for USD at the same spot rate.

Review 12.4

Comprehension

Answer these questions on paper or in the Interactive Textbook.

1. Identify the risks to an importer if a prepayment is used.
2. Define insurance. Explain how it can reduce financial risk.
3. Define the term 'hedging'.
4. Outline the strategies a global business may use to hedge against payment risks.
5. Evaluate the advantage of a currency option contract.
6. What would be a disadvantage of entering into a derivative contract?
7. Outline the effect of changes in the value of currencies on the financial planning of a global business.
8. Explain the role international banks have in reducing payment risk.

Chapter summary

A business must maintain liquidity to pay its expenses and short-term liabilities when they are due.

Cash flow statements can be used to predict a business's cash inflows and outflows over time to identify periods of liquidity problems. With the use of budgets, cash can be managed to ensure that there will be enough cash on hand when required in the future.

Strategies available to manage cash flow in a business include spreading the distribution of payments, offering discounts for early payment to account customers and factoring.

Cash inflow can be increased by factoring accounts receivable or offering discounts for early payment of credit accounts. Each will actually decrease the value of total current assets. However, cash will be available more quickly.

Working capital is the current assets used in the day-to-day running of the business.
Net working capital = current assets – current liabilities. Managers must work out the best current asset to current liability ratio for the business.

Financial managers develop strategies to increase the amount of cash in the business account and to increase the reliability and frequency of cash inflow.

Businesses may need to write off bad debts and carefully monitor their accounts receivable.

Inventory includes raw materials, work in progress and finished goods. Inventory must be carefully monitored to avoid lost or damaged stock.

Businesses must control their current liabilities – these include accounts payable, short-term loans and overdrafts.

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By stretching accounts payable to pay on the last day of the credit period, a business can hold on to its cash for longer and pay more urgent expenses on time.

The main strategies for working capital management include leasing, and sale and leaseback.

Short-term loans should be used for short-term needs.

In order to manage profitability, both cost controls (fixed and variable, cost centres and expenses minimisation) and revenue controls relating to marketing objectives (sales forecasts, sales mix and pricing policies) should be used.

Fixed expenses (for example, rent) do not change when a business produces more goods, while variable expenses vary as output varies.

Global businesses need to take into account exchange rates in their financial planning. Appreciation (increase in value) of the Australian dollar (AUD) means imports will be cheaper and exports will be more expensive.

Depreciation (decreasing value) of the AUD means that exports are cheaper and imports are more expensive.

Global businesses may borrow from financial markets in other countries and generally aim to borrow at the lowest interest rate.

Methods of international payment include payment in advance, letters of credit, clean payments and bills of exchange.

Hedging is used to reduce the financial risk in global transactions due to changes in the exchange rate.

Derivatives, a form of hedging, include forward exchange contracts, currency option contracts and swap contracts.

End-of-chapter tasks

Chapter revision tasks

1 Rewrite the following paragraphs using the words listed in the box to fill in the blanks.

forecasts	leasing	discounts	receivable	decrease
centres	exchange	payable	expensive	planning
payments	variable	increase	liabilities	exports
overdrafts	sale	cheaper	expense	factoring

A business must maintain liquidity to pay its short-term _____ when it is due. Strategies available to manage cash flow in a business include spreading the distribution of _____, offering _____ for early payment to account customers and _____. However, factoring accounts _____ or offering discounts for early payment of credit accounts will actually _____ the value of total current assets. Businesses must also control their current liabilities. These include accounts _____, short-term loans and _____. The main strategies for working capital management include _____ and _____ and leaseback.

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In order to manage profitability, both cost controls (fixed and _____, cost _____ and _____ minimisation) and revenue controls relating to marketing objectives (sales _____, sales mix and pricing policies) should be used.

Global businesses need to take into account _____ rates in their financial _____. Appreciation (_____ in value) of the Australian dollar means imports will be _____ and _____ will be more expensive. Depreciation (decreasing value) of the AUD means that exports are cheaper and imports are more _____.

2 Outline an appropriate cash flow management strategy that a business could use for each of the following situations.

- **A** Gouda's Eatery has experienced a cash shortfall for the months of December, January and February owing to an increased number of customers purchasing goods on account.
- **B** Fine Furniture requires cash to pay its annual insurance premium of $100 000.
- **C** Unseasonable cold weather has seen the warehouse of Treat's Ice Cream become overstocked with food supplies.
- **D** Management of Quality Recruiters has decided to update its information technology equipment. The business does not have the substantial amount of money needed to purchase this equipment.
- **E** Kingsley and Associates Pty Ltd is a small accountancy firm that has experienced increasing costs and frustration complying with changes to Australian taxation requirements. Currently, the owner is spending too much time working out taxation issues and not enough time on clients' financial returns.
- **F** Drip Tap Plumbers has received a number of large invoices due over the next eight weeks.

Multiple-choice questions

1 What are cash inflows the result of?

- **A** Payments to suppliers and interest earned on investments
- **B** Receipt of dividends and the business's loan repayments
- **C** Payments of dividends and issues of shares
- **D** Cash sales and the collection of accounts receivable

2 Which of the following are examples of variable costs?

- **A** Leases, rent and salaries
- **B** Leases, rent and wages
- **C** Rent, telephone and electricity
- **D** Inputs, raw materials and casual wages

3 Fred Flintlock Merchandising imports much of its stock from Thailand. Which method of payment would provide Fred Flintlock Merchandising with the greatest amount of risk?

- **A** Letter of credit
- **B** Bill of exchange
- **C** Clean payment
- **D** Payment in advance

4 Net working capital is:

- **A** currents assets + current liabilities.
- **B** current assets ÷ current liabilities.
- **C** total assets – total liabilities.
- **D** current assets – current liabilities.

5 What would be the best strategy for a business to increase its gross profit?

- **A** Using cost centres
- **B** Reducing its fixed costs
- **C** Minimising its expenses
- **D** Using sale and leaseback

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6 What is a derivative?

A An investigation of the creditworthiness and ability of a customer to make future payments
B An agreement to buy a foreign currency at an agreed price on a specific day in the future
C A way to protect the business against political unrest
D A way to ensure delivery of goods immediately

7 Debtors is a term used for:

A prepaid expenses.
B accounts payable.
C undistributed profits.
D accounts receivable.

8 Why would a business factor its accounts receivable?

A To increase its current assets
B To increase its profitability
C To improve its cash flow
D To improve the efficiency of the business

9 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 wineries selling bottled wine to Fiji
B Australian manufacturers purchasing component parts from Japan
C Mexican travel agents organising tours for Australians
D Chinese shareholders of an Australian dairy

10 Australian businesses export to Japan. What would happen if the value of the Australian dollar increased compared to the Japanese yen?

A There would be no effect on Japanese businesses.
B Japanese businesses would find Australian products more affordable.
C Australian imports from Japan would become more expensive.
D Australian products would become more expensive for Japanese businesses.

Short-answer questions

1 Discuss the advantages and disadvantages of leasing equipment compared with buying.

2 Copy the following financial statement and then complete it by calculating the closing balance for January to April and the opening balance for February, March and April.

Financial statement for Greg's Motorcycle Parts Warehouse Pty Ltd

	January $	February $	March $	April $
Opening balance	2160			
Sales revenue	20690	18390	15100	12650
less Operating expenses				
Lease of premises	4200	4200	4200	4200
Wages	5685	5685	4340	4340
Utilities	1380	1300	1260	1235
Closing balance				

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3 Identify the trend in sales revenue for Greg's Motorcycle Parts Warehouse Pty Ltd.

4 Which of Greg's operating costs are fixed costs and which are variable costs?

5 Is there any evidence in the data to suggest how Greg is trying to deal with his changing revenue?

6 Suggest a financial strategy that would assist Greg in his financial planning.

Extended-response question

Evaluate why it is important for a business to develop financial strategies to maintain its liquidity.

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TOPIC 4
Human resources

25% of indicative time

Principal focus

This topic focuses on the impact human resource management has on the performance of a business.

Introduction

Video 13.1
Introducing Topic 3
Human Resources

Human resources is the process of managing the employees of a business. For any organisation to be successful, it is essential that it develops a highly skilled and motivated group of employees – a team that is able to work together to achieve the business's objectives. Change is a part of every business and it affects all areas of a business's operations, including employment relations. This change may come from government legislation and policy, social influences or economic activity. It is essential for a business to develop programs and initiatives that allow it to consider how these changes impact on its employees and how best to respond to these impacts. Much of the employment relationship is regulated through government tribunals and legislation. This extends to the processes of wage negotiation, working conditions and workplace conflict. The extent to which stakeholders within the employment relationship work cooperatively in resolving their differences can have a considerable effect on the success of the business.

Outcomes

Students will:

- evaluate how internal and external changes can influence management strategies
- discuss management's responsibilities regarding social and ethical matters
- analyse how large and global organisations use processes and functions
- explain the impact that management strategies have on businesses
- evaluate how a business's performance is impacted by effective management
- investigate current issues affecting businesses
- organise and evaluate information about real and potential situations affecting businesses
- communicate, using effective formats, details of business information, issues and concepts.

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Content

Students will learn about the role, influences, processes and strategies of human resources, through examination of current business issues, and investigation of real and potential business situations.

By the end of this topic

Students will have learned to:

- discuss how the employment contract creation process is influenced by government
- explain how corporate social responsibility is demonstrated in the human resource management of a business
- analyse workplace disputes to understand both the causes and the strategies by which they were resolved
- examine why a global business will benefit from having a culturally competent, diverse workforce
- explain the dependencies between human resources and other business functions
- compare the negotiation of individual contacts with that of enterprise/collective agreements
- discuss why the possibilities for outsourcing offered by a global market have both advantages and disadvantages
- evaluate how effective a business's human resource management strategies are, and recommend suitable alternatives.

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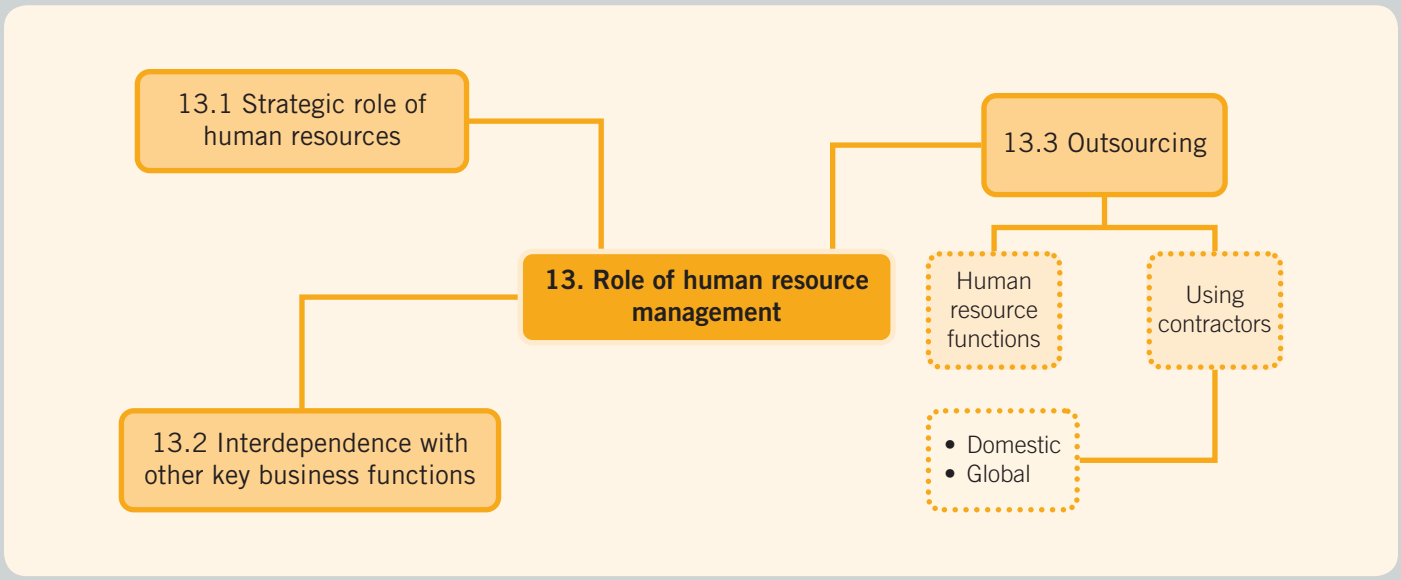
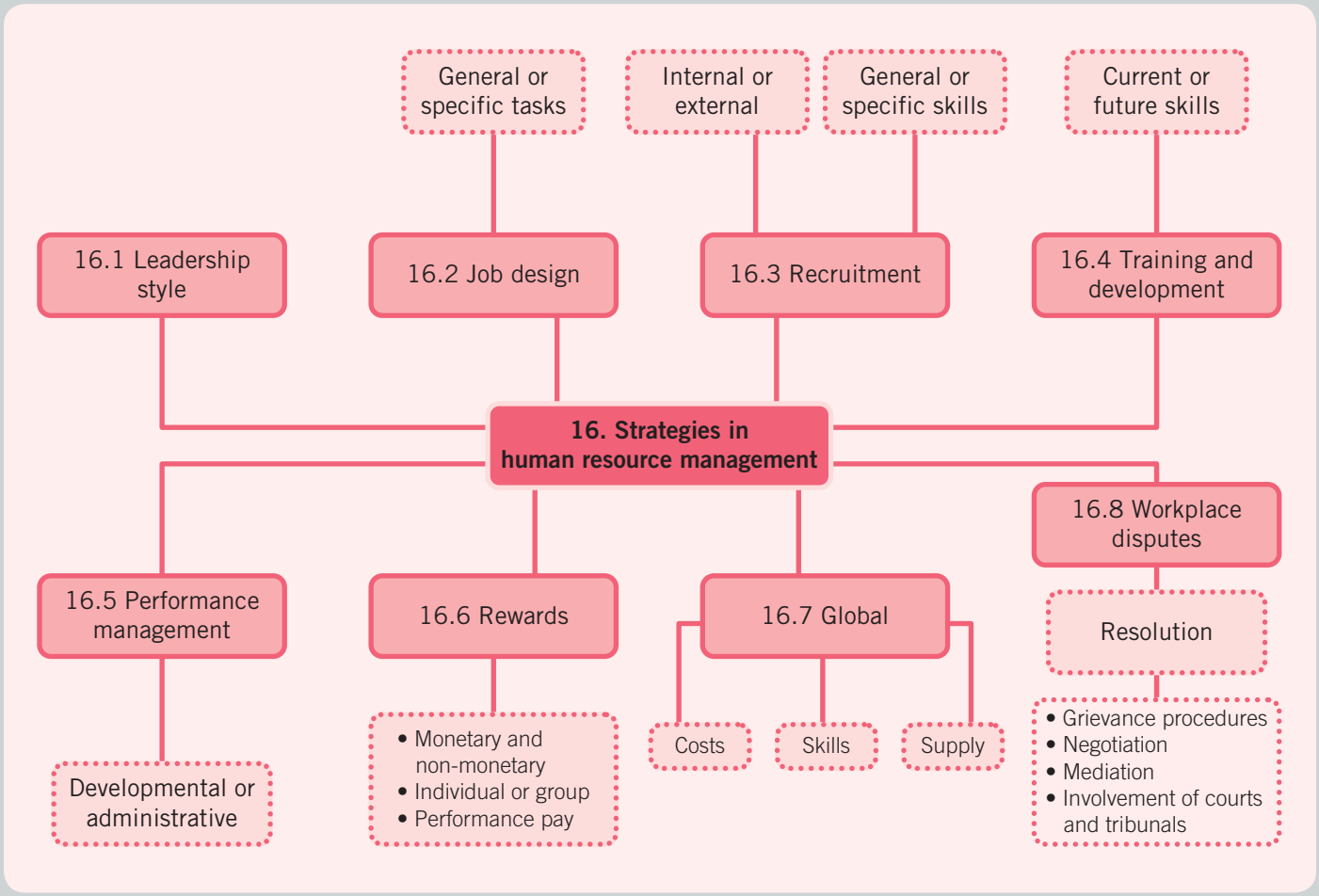
Human resources





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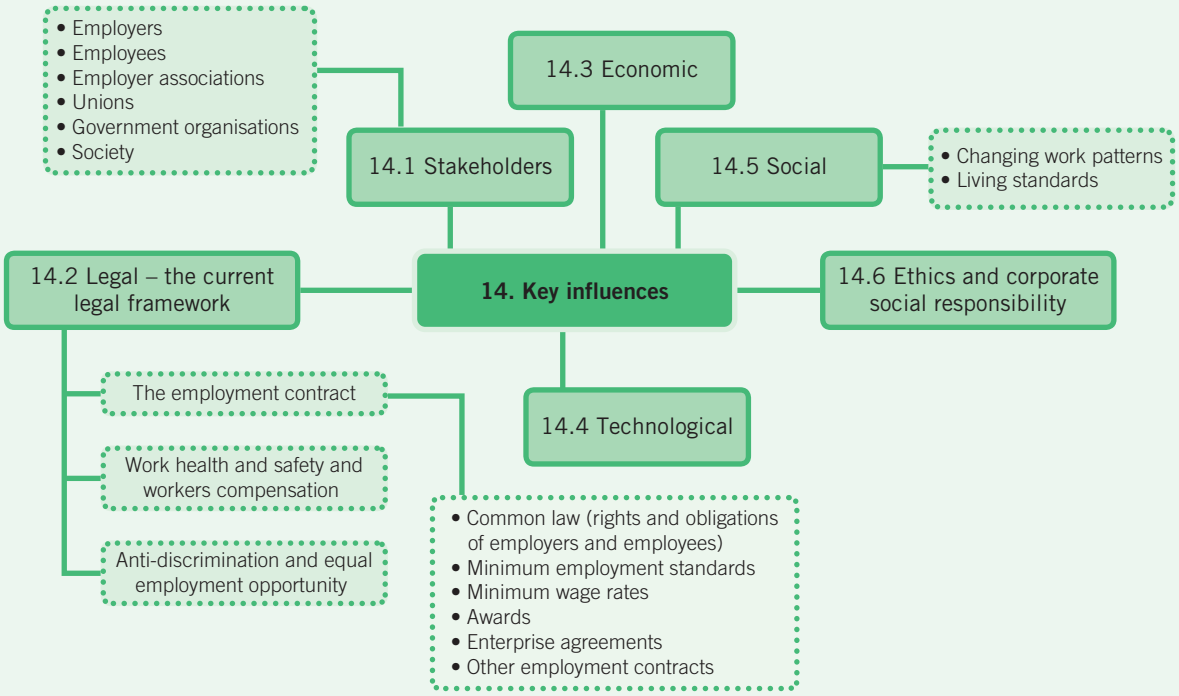

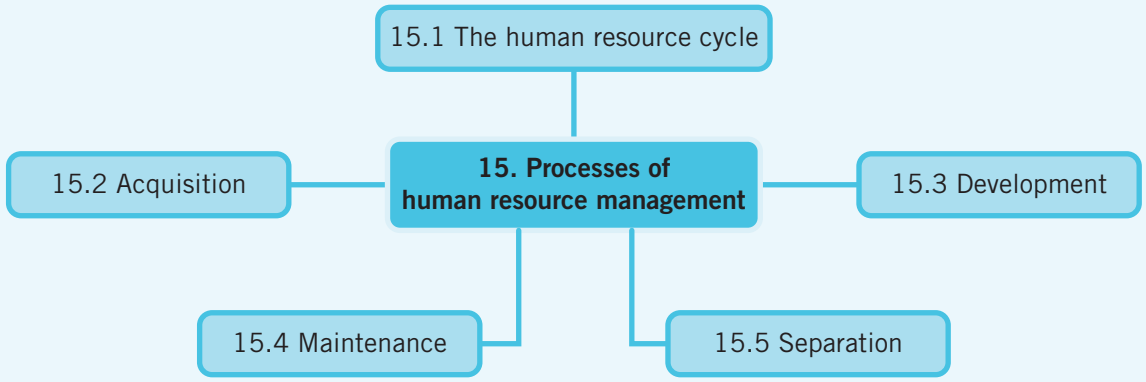

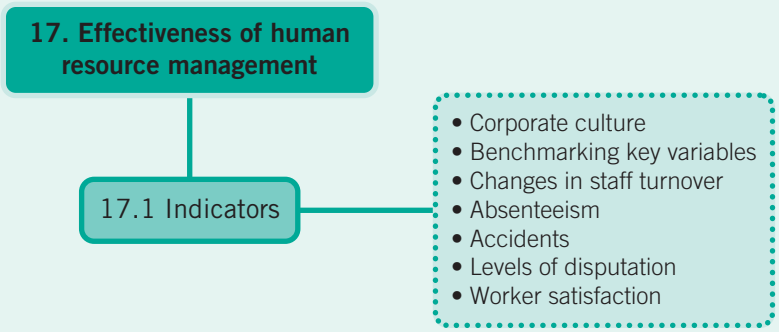

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13 Role of human resource management

Chapter objectives

In this chapter, students will:

- investigate the strategic role of human resources
- analyse human resources' interdependence with other key business functions
- explain and evaluate outsourcing.

Key terms

- contract for service
- contract of service
- human resources
- human resource management
- outsourcing
- performance review

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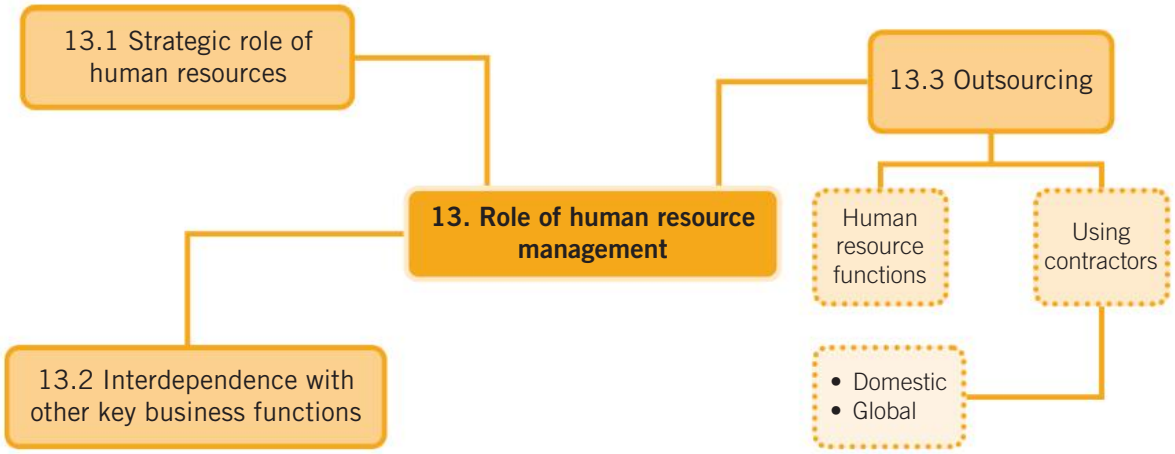
13.0 Introduction



Source 13.1 Role of human resource management concept map

The relationship between employers and employees is a fundamental part of any successful business. Many businesses acknowledge that to be successful they need to value the contribution of their employees, motivate them to work to the best of their ability and develop strategies to enhance their skills and abilities.

Human resources is the process of managing employees in a workplace. It involves:

- ensuring the business has the appropriate staff working towards the goals of the business
- recruiting the necessary staff to provide the business with the skills and expertise needed to allow the business to operate successfully
- implementing programs aimed at constantly developing the skills and knowledge of all staff
- rewarding and motivating valued employees
- working within the legal framework that regulates the employment relationship in such areas as wage negotiation, occupational health and safety, and unfair dismissal.

13.1 Strategic role of human resources

Human resource management refers to the approach taken by management to the most valuable asset of an organisation – its staff. These are the people working at the business who contribute to the achievement of the objectives and goals of the business. The strategic role of human resource management is designed to help businesses to better support the needs of their employees, while at the same time promoting the goals of the organisation.

Human resource management deals with many aspects of a business that affect its relationship with employees. These include recruitment, training and development, incentives and termination. Strategic human resource management is the ability of senior managers within a business to develop proactive strategies in the management of its people. It requires managers to think ahead, and develop methods to improve how the business meets its employees' needs, and how the employees meet the business's needs.

By being proactive and adopting a long-term thinking approach, managers may seek to affect and improve a diverse range of human resource issues within the business. This includes its recruitment policies and practices, employment performance review techniques, and training and development strategies.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Human resources The process of managing employees in a workplace.

Human resource management The process of managing staff within an organisation. It focuses on the relationship between the employer and the employee and how each of these stakeholders is able to work to achieve the goals of the business and their own individual goals.

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Source 13.2 Recruitment is a role of human resource management.

The strategic role of human resource management is derived from the organisation's strategic plans and objectives. This plan will provide the basis for senior human resource managers to determine the long-term employment needs of the business. The business must then determine if its existing employees have the skills to achieve its goals. A plan is then established as a guideline for the company to determine the training and development needs of the business and the qualifications and skills of external individuals who may be recruited by the business.

The next stage is for the business to retain the employees who have been hired and ensure their work is consistent with the expectations of the employer. It is expected that the efforts of staff help move the business in the desired direction. By doing this, the goals of the business can successfully be achieved.

The business must also develop appropriate **performance review** measures to examine the effectiveness and efficiency of its employees. These measures must be realistic, be mindful of the existing skills of employees and adopt benchmarks similar to those of the business's major competitors.

Performance review Used to determine the strengths of an employee and develop strategies to assist the employee to improve on areas of development.

Source 13.3 Businesses use performance reviews to examine the effectiveness and efficiency of their employees.

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Benefits of adopting a strategic role to human resources

Many businesses operating in Australia employ staff, with more than 46 per cent employed in small business. That means that businesses must consider the role of human resource planning within their organisations. By adopting a strategic or long-term view to human resource management, a business should be able to achieve the benefits outlined in Source 13.4.

Source 13.4 Benefits of a strategic role of human resources

Benefits
The development of a highly qualified workforce that fosters skill development and employee recognition.
The introduction of systems and procedures that deal effectively with workplace conflict and grievances.
The employment of a workforce relevant to the organisational needs of the business from a long-term perspective.
The workforce itself being the competitive advantage that the business has over its competitors.

Review 13.1

Comprehension

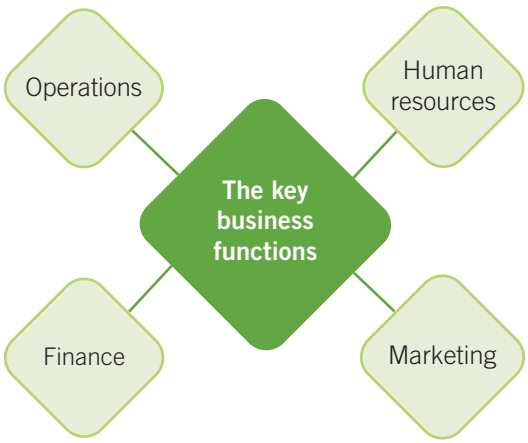
Answer these questions on paper or in the Interactive Textbook.

1. Describe the role of human resource management within a business.
2. Identify four features of the strategic role of human resources and explain how they differ from the operational role of human resource managers.
3. Evaluate the benefits to a business of adopting a strategic role to human resource management.

13.2 Interdependence with other key business functions

A successful business is similar in some ways to a successful sporting team. Each player has a key role in ensuring the team plays well and wins the game. Likewise, in business it is important for each key business function to work independently as a single unit and also as a team to ensure the business runs successfully. Each key business function must work effectively with other functions to achieve the goals of the business. The business becomes a team in which the four key players of operations, human resources, marketing and finance must work together to win the game – that is, to ensure the success of the business (see Source 13.5).

For instance, the operations function refers to the physical production of a good or the provision of a service. In the case of manufacturing, inputs are combined and processed to transform them into a finished product. These inputs may be raw materials or partly processed products. For example, a builder will require timber, concrete, glass, steel and gyprock to combine in order to build a house. Without the builder's skills, experience and knowledge, the house will not be built. Employees are a key input into business operations.



Source 13.5 The key business functions

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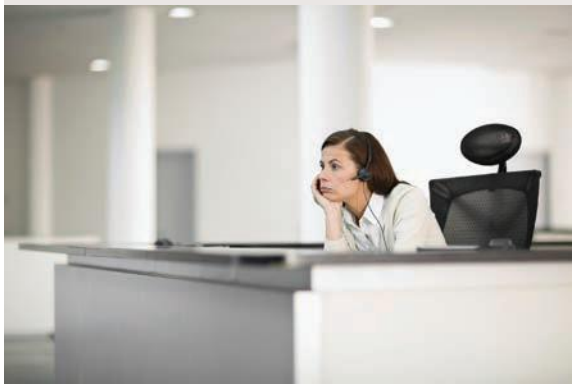
Human resources' relationship to the operations function

The operations function is concerned with the process of production and supplying a particular good or service. It works closely with the human resource department to ensure that the business has recruited staff with the relevant skills and experience necessary to produce the product. The human resource department will monitor the performance of employees involved in the production of goods and services, and training and development initiatives may also be implemented.

Human resources' relationship to the marketing function

The human resource function is focused on the role of employees within an organisation. Staff must be motivated and skilled to develop products within the business that cater to the needs and wants of potential customers. It is through the marketing process that a business is able to determine the skills required for employees to produce the desired product. The features of the product often come about through market research. In many instances, staff are the public face of the business. Their actions towards consumers will influence the decision of a consumer to purchase a product, return to the business and recommend the business to others.

Source 13.6 Employees are often the face of a business.



Human resources' relationship to the finance function

One of the key goals of human resources is to recruit skilled and highly motivated staff. This in turn benefits the profitability of the business. As such, budgets are often established within businesses that allocate funds towards training and development, workplace education issues such as affirmative action and occupational health and safety, and remuneration. Human resource managers must work within these budgets to adequately provide for the needs of the employees.

Outsourcing Occurs when a business takes a part of a key function and gives it to another company to perform.

Source 13.7 Human resources and finance are interdependent.

Review 13.2

Analysis

Answer this question on paper or in the Interactive Textbook.

Describe the role of employees in achieving the short-term and long-term goals of a business.

13.3 Outsourcing

The key function of any business is to deliver a quality product or service to its customers. Given this, businesses must also engage in the recruitment of staff, the development of training programs and the review of employee performance. Some businesses lack the funds or expertise to employ specialist human resource managers to manage the detailed yet diverse role that employment relations within a business encompasses. **Outsourcing** is a common business practice in which a company employs another company to complete part of its business functions.

The human resource function

There are a range of reasons why a company might choose to outsource the human resource

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function, rather than maintaining an in-house human resource team.

- Outsourcing provides the ability to access staff whose speciality is human resource management. These staff have a much better understanding of issues related to employment relations and can advise the business on the most appropriate human resource strategies.

Business Bite

Source 13.8 Jobseekers queue to apply for positions at a call centre job fair in Manila.

The global outsourcing industry in the Philippines has grown during the COVID-19 pandemic, when most companies are working remotely.

Magellan Solutions Outsourcing Inc. (Magellan) is an inbound and outbound call centre and BPO provider in the Philippines. It lists some of the reasons why top Australian companies chose the Philippines as their outsourcing destination as:

- Low-cost price: Philippine call centres are more cost-effective compared to Australian outsourcing companies. The hourly rate for an Australian outsourcing company is between $35 and $55. That is $20 to $40 more compared to the price of a Philippine outsourcing service. The business process outsourcing (BPO) industry in the Philippines is popular with foreign companies that want to save money, as they can use the saved amount for their expansion instead.
- Time difference and opening hours: The time difference between the Philippines and Australia is only two hours. This makes communication easier. Also, Australian businesses are able to operate beyond typical business hours as Philippine call centres operate 24/7.
- Distance: Business owners want to visit the people working for them to track their performance. The distance between the offshore company and main headquarters can be an issue.
- Proximity: Australia is only a six-hour flight away from the Philippines, and plane tickets are inexpensive because of the short distance.
- Talent: The Philippines is the call centre capital of the world and therefore has a huge pool of talent in the BPO industry to draw on. The Philippines outsourcing industry does not only specialise in customer service. It also offers data entry, tech support, back office services, among other services.
- Business models: Clients have the liberty to choose the business model that suits their organisation. BPO companies can also help you set goals for your business. This is great not only for big companies but for start-up businesses as well.
- More focus on important business matters: Outsourcing administrative and support functions to a BPO company allows a business to focus more on those other matters from which the revenue comes.

https://www.magellan-solutions.com/blog/australian-companies-that-outsource/

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- It allows managers of the business to focus on the core business operations. This means that the focus of the business is on production and attending to the needs of its customers. Other issues such as recruitment and training and development are handled by an external business.
- There can be cost savings. Outsourcing reduces the need for the business to employ full-time staff where in many instances – for smaller businesses, for example – a permanent human resource manager may not be required.

However, there may also be issues with outsourcing the human resource function.

- A major concern when outsourcing human resources is the possibility that the company being outsourced to may lack an understanding of the key aspects of the business. This could include the business culture and existing workplace conflict issues.
- It is vital to maintain good employee management practices. The relationships line managers have with their staff must continue to be developed and handled within the business itself, despite the outsourced business being responsible for human resource issues.

The decision to outsource part or all of a business human resource function is one that must be considered carefully.

Contract for service Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually for a fixed period.

Contract of service Exists where an employee offers his or her services to an organisation on a regular basis and is subject to the lawful control and authority of the employer.

Using contractors

The employment contract in the Australian workforce is between an employer and the employee. Many of the conditions outlined in this contract are controlled by various state and federal laws. These conditions apply to all workplaces. The growth of outsourcing and the increase in self-employment have meant that the traditional definition of an employee has changed.

An employee can no longer be defined only as an individual who offers his or her labour to a business in return for payment. A business might hire a marketing consultant, for example, even though they are not regarded by the business as an employee. The law, however, regards an employee as a person who is subject to a contract of service. The employment contract is based on the employee offering his or her services on a regular basis and being subject to the lawful control and authority of the employer. The employer is able to tell the employee what job to do and how to do that job. The position of employment is ongoing and will not be terminated once a task has been completed.

In addition to employees, a business may also have independent contractors. A staff member on an independent contract is quite different from a permanent employee. Their employment by one employer is not ongoing and an agreed fee is paid for the service provided by the contractor. The common legal definition for this type of employee is a person who is subject to a **contract for service**. Builders, lawyers and electricians are commonly independent contractors rather than employees. The differences between people employed under a **contract of service** and independent contractors who work under a contract for service are outlined in Source 13.9.

Foreign contractors

Given the global nature of businesses today, Australian organisations are more easily able to access the use of foreign labour resources. Rather than establish human resource departments in these countries, Australian businesses are able to contract foreign businesses to provide a ready-made workforce. This allows the Australian business to access the use of labour without having to consider such issues as minimum labour requirements, occupational health and safety laws and termination. For example, many Australian businesses have their call centres offshore.

Ethical Spotlight 13.1

Should Australian businesses deal with foreign contractors who may not follow labour law requirements in the foreign country, despite the cost-saving benefits that this may bring?

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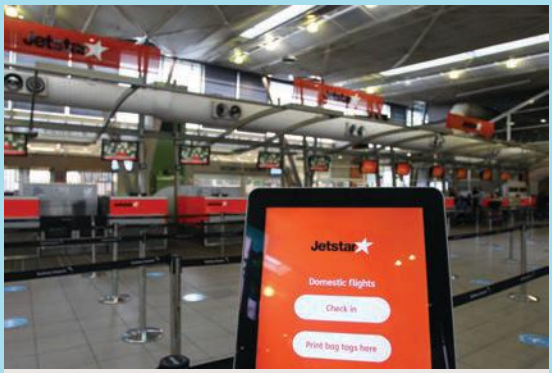
Source 13.9 Differences between employees and independent contractors

	Employee	Independent contractor
Length of employment	Regular and continuous	Fixed term
Income	Subject to negotiated wage agreement or award conditions	Fixed agreed rate
Workers compensation	Insurance and protection are provided by the employer	Must provide own insurance
Tax	Employer is responsible for PAYG (pay as you go) tax deductions and superannuation	Responsible for own tax requirements; is required to pay provisional tax. This means that tax paid is in regular instalments throughout the year, often every three months.
Legal entitlements	Subject to government legislation; includes sick leave, maternity and paternity leave, annual leave and long service leave	No legal entitlements from the organisation seeking the contractor's service; there are no on-costs, such as workers compensation insurance, long service leave and sick leave entitlements.

Business Bite

Do you know who you are really flying with when flying Jetstar? The airline hires cabin crew from (at least) two foreign companies: Valuair (Singapore) and Tour East (Thailand; TET). Valuair staff live in Singapore and work on flights between Singapore and other Jetstar destinations, including Australian destinations. A Valuair employee may, for example, fly first from Singapore to Sydney, but then serve on any number of flights travelling across other Australian capital cities, before serving on a flight leaving Australia back to Singapore.

Jetstar is obliged to comply with the Aircraft Cabin Crew Award 2010, made under the provisions of the *Fair Work Act 2009* (Cth). At that time, the minimum wage under the award for a cabin crew member was $A650.80 per week, or $A2820 per month. The Fair Work Ombudsman (FWO) stated that Valuair and TET employees should also be paid according to this award, at least in respect of their work on flights between Australian cities.



Source 13.10 Jetstar hires cabin crew from foreign companies.

Digital quiz
Please see the Interactive Textbook to access digital activities.

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Chapter summary

Human resources is the process of managing an organisation's workforce. It involves:
- reviewing the goals of the business to ensure the business has the appropriate staff
- recruiting the necessary staff to provide the business with the skills and expertise needed to allow the business to operate successfully
- implementing programs aimed at constantly developing the skills and knowledge of all staff
- rewarding valued employees
- working within the legal framework that regulates the employment relationship in such areas as wage negotiation, occupational health and safety and unfair dismissal.

The strategic role of human resource management is designed to assist businesses to better meet the needs of their employees while at the same time promoting company goals.

The strategic role of human resource management is derived from the organisation's strategic plan and objectives. This plan will provide the basis for senior human resource managers to determine the long-term employment needs of the business.

Human resources is one of four key business functions. The other business functions are operations, marketing and finance. Each of these functions works closely with the others to achieve the goals of the business.

Outsourcing is a common business practice in which a company takes a part of its business functions and gives that part to another company to complete.

Benefits of outsourcing the human resource function include:
- the ability to access staff whose speciality is human resource management
- allowing managers of the business to focus on the core business operations
- generating cost savings.

Issues concerned with outsourcing the human resource function include the following:
- The company that the human resource function is outsourced to may lack an understanding of the key aspects of the business.
- Management within the business must still take some responsibility for the staff.

Independent contractors exist in a situation where an individual's employment by one employer is not ongoing and an agreed fee is paid for the service.

Rather than establish human resource departments in other countries, Australian businesses are able to contract foreign businesses to provide a ready-made workforce.

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End-of-chapter tasks

Chapter revision task

Create a mind map that defines the strategic role of human resource management. Using this mind map, detail the relationship between human resources and each of the other key business functions: marketing, finance and operations.

Multiple-choice questions

1 Which of the following are the two key stakeholders in human resource management?

- **A** Employers and government tribunals
- **B** Employees and employers
- **C** Unions and employer associations
- **D** Society and employees

2 Which of the following describes the strategic role of human resources?

- **A** The development of training and development initiatives within the business
- **B** The decision to recruit new staff as a result of a review of the business's long-term plans
- **C** A plan that provides the basis for senior human resource managers to determine the long-term employment needs of the business
- **D** The use of a foreign business to supply an existing group of employees

3 Which of the following describes the key difference between an employee and a contractor?

- **A** A contractor has ongoing employment within the organisation, while an employee's employment concludes after a fixed period.
- **B** A contractor receives ongoing income from an organisation, while an employee is paid income for completing a specific task.
- **C** An employee is responsible for organising their own superannuation contributions, while a contractor's superannuation is the responsibility of the employer.
- **D** An employee has ongoing employment within the organisation, while a contractor is employed for a fixed period of time.

4 Which of the following statements best describes the relationship between the human resource and operations functions of a business?

- **A** The operations department works closely with the human resource department to recruit and develop staff with the relevant skills and qualifications.
- **B** The operations department produces goods and services within a budget developed by the human resource department.
- **C** The operations department is responsible for the recruitment of staff, who then produce goods and services favourable to the needs and wants of consumers.
- **D** The operations department develops goods and services for which the human resource function becomes responsible for promoting.

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5 Which of the following best describes the concept of outsourcing?

A The process whereby a company takes a part of its business functions and gives that part to another company to complete
B The process whereby a company completes all aspects of its operations internally
C The process whereby a company recruits additional staff to assist during periods of high consumer demand
D The process whereby a company produces goods for a distributor to then sell

6 Which of the following is a disadvantage to a business if the human resource function of that business is outsourced to an external organisation?

A The company that the human resource function is outsourced to may lack an understanding of the key aspects of the business.
B The key relationship between staff and their line managers must continue to be developed within the business itself, without the assistance of the external company.
C The decision of a business to outsource its human resource function can generate cost savings through increased employee supervision.
D Staff of the external company would have a much better understanding of issues related to employment relations and can advise the business on the most appropriate human resource strategies.

7 Which of the following aspects of human resources would a business not be able to outsource?

A Training and development
B Payroll administration procedures
C Supervision of staff
D Recruitment

8 According to Australian workplace laws, how is contract work defined?

A Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually for a fixed period
B Exists where employment is ongoing and regular payments are received by the employee for continued work with the business
C Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually for a continued period of time
D Exists where employment is not ongoing and some regular payments are received by the employee for continued work with the business

9 Which of the following statements describes a benefit of an Australian business employing the services of a foreign contractor?

A The contractor's employment with the business is not ongoing and allows the Australian business to be more flexible.
B This allows the Australian business to access the use of labour without having to consider such issues as minimum labour requirements, occupational health and safety laws, and termination.
C The contractor is able to quickly access a supply of available workers without the business having to extensively recruit and train new staff.
D This allows the Australian business to bypass domestic labour law requirements and make use of less expensive labour overseas.

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10 Which of the following statements best describes the relationship between the finance and human resource functions of a business?

A Finance managers determine how many employees the business can hire, based on salary costs.

B Human resource managers are given a budget within which they must work to adequately provide for the needs of employees.

C Finance managers make decisions about what training and development programs can be funded.

D Human resource managers generate direct profit for the business.

Short-answer questions

1 Identify and describe two benefits to a business of outsourcing its human resource function.

2 Outline the benefits to an Australian business of using a foreign contractor as opposed to an Australian-based contractor.

Extended-response question

Describe the strategic role that human resource management has within a business and analyse this role in human resources' interdependence with other key business functions.

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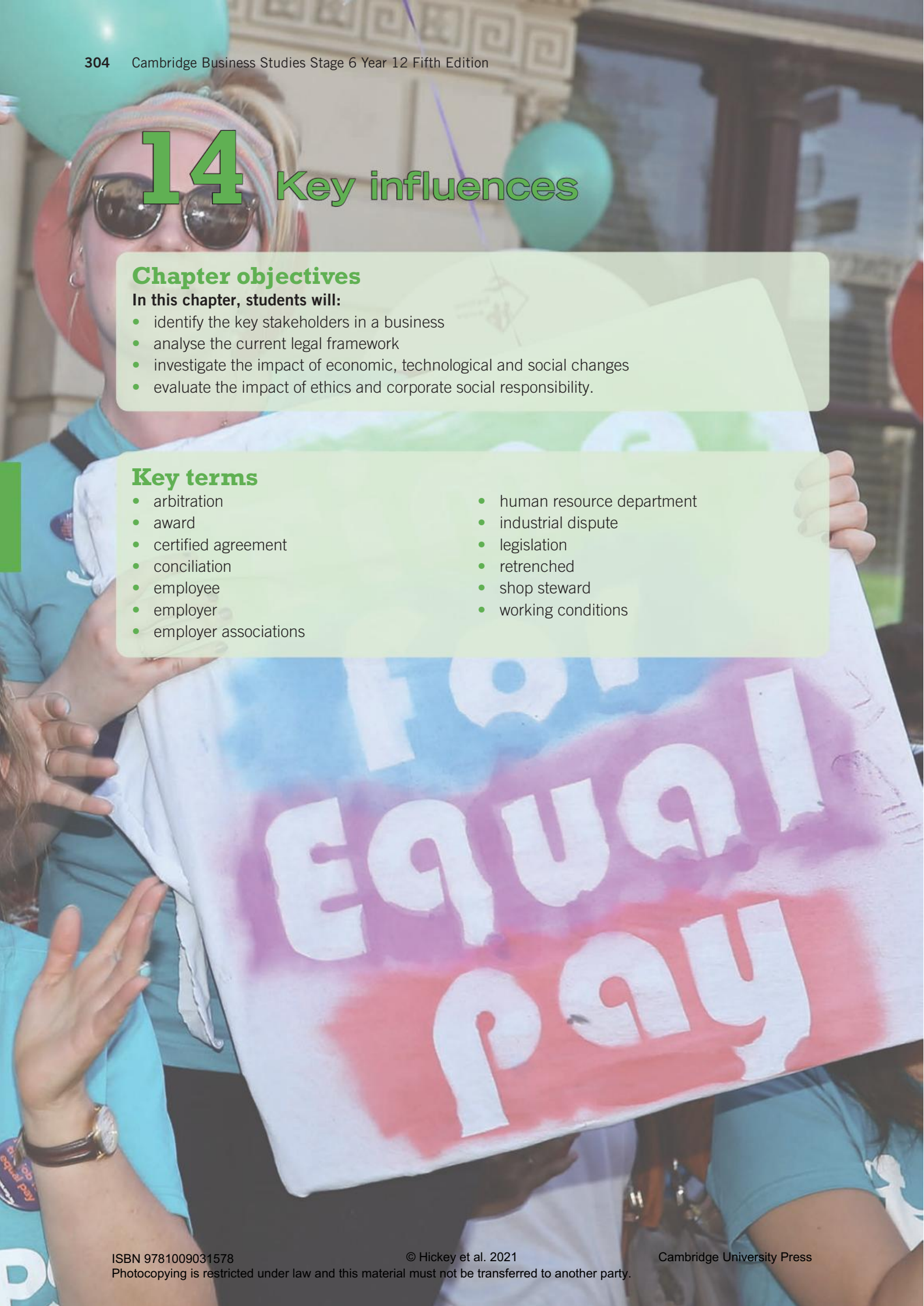
14 Key influences



Chapter objectives

In this chapter, students will:

- identify the key stakeholders in a business
- analyse the current legal framework
- investigate the impact of economic, technological and social changes
- evaluate the impact of ethics and corporate social responsibility.

Key terms

- arbitration
- award
- certified agreement
- conciliation
- employee
- employer
- employer associations
- human resource department
- industrial dispute
- legislation
- retrenched
- shop steward
- working conditions

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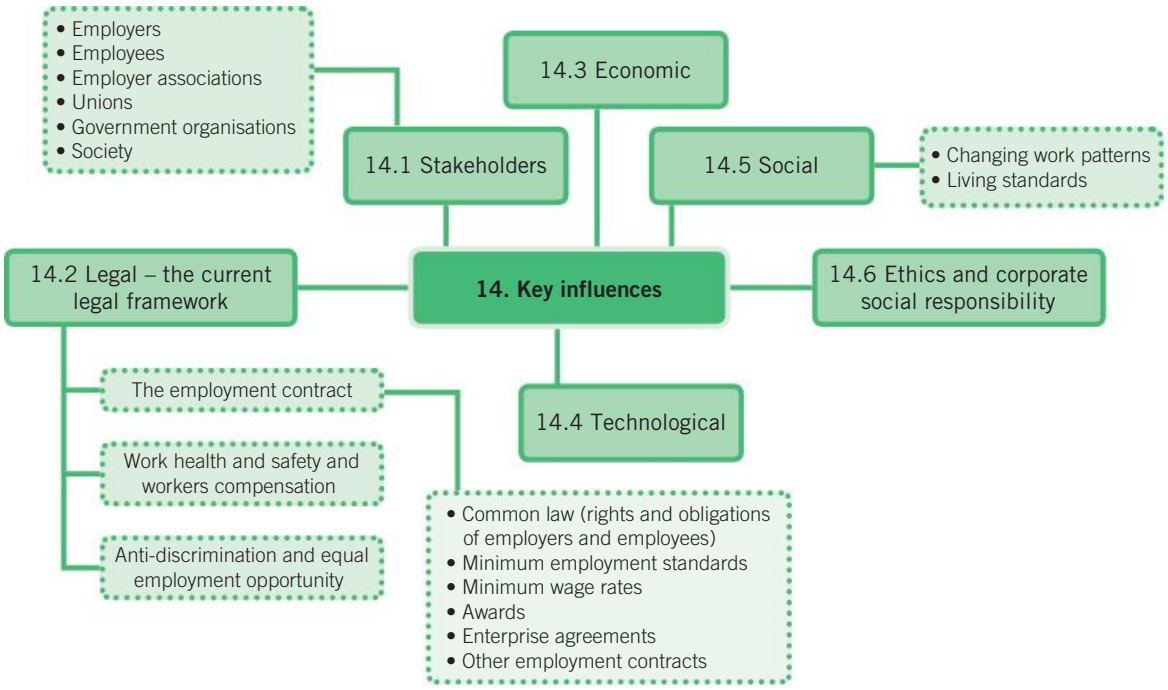
14.0 Introduction

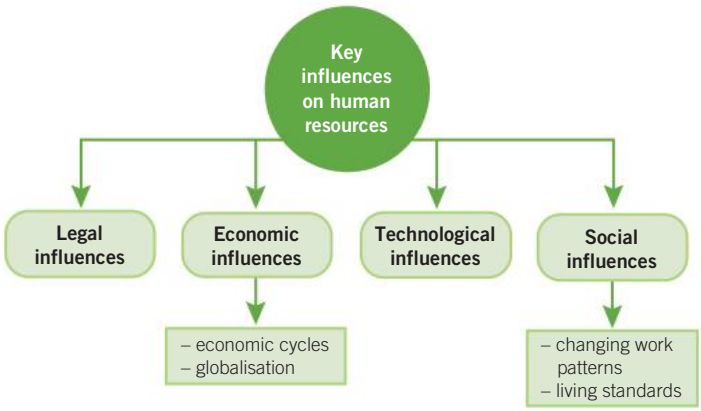


Source 14.1 Key influences concept map

There are many stakeholders involved in the employment relationship (Source 14.2). Each stakeholder seeks to protect and promote their own interests.

In addition, there are four key influences on human resources (Source 14.3).

Source 14.2 The six stakeholders in the employment relations process



Source 14.3 The four key influences on human resources

14.1 Stakeholders

Employers

An **employer** is the individual or organisation that pays others to work for their business. The employers are often the owners of the business and, as such, take responsibility for ensuring that the business has the appropriate staff to achieve the organisation's goals. In large businesses, the shareholders may appoint

Digital quiz
Please see the Interactive Textbook to access digital activities.

Employer An individual or organisation that pays others to work for its business.

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a group of managers to take on this responsibility. The managers consult with the owners to develop and implement strategies aimed at increasing the profitability of the business.

Some businesses employ a large number of staff members, while smaller businesses may use the services of fewer than five people. Australia's major banks, such as ANZ, National Australia Bank (NAB), Commonwealth Bank and Westpac, are part of Australia's financial services industry, which employs more than 200 000 Australians each year.

Human resource department A specialist unit in a business that has as its main role the management of the issues involved in the employment relationship.

Employee An individual who provides his or her skills to a business in return for a regular source of income.

Employer associations Organisations that aim to promote the interests of employers within the business environment.

Large businesses will have a **human resource department** whose focus is the management of all employee-related issues in the workplace. This allows managers to specialise in different operations of the business. The role of the human resource department is to manage the issues involved in the employer–employee relationship.

A typical human resource department would:

- work with other departments to recruit the appropriate staff for the business
- ensure that the working conditions and benefits that the employees receive comply with federal and state government regulations
- implement a range of training and development programs to cater to the changing staffing needs of the business
- develop a number of rewards for employees to show them how valued they are in the business.

Employees

An **employee** is an individual who provides his or her skills to a business in return for a regular source of income. Employees are a key input into the production process. It is the responsibility of employees to complete their tasks in a manner that is lawfully described by the employer and to the best of their ability.

Traditionally, employees have been regarded as the servants within the employment relationship, and for their efforts they are rewarded with a wage or salary. Many businesses have now sought to include employees in the decision-making process. This provides employees with an increased sense of responsibility and empowerment within the organisation. It is believed that providing employees with a greater role in the business means they will work more efficiently, effectively and with higher motivation.

While income is still very important, many employees are seeking a greater recognition of the role that family and leisure have in their lives. Employees, with the assistance of trade unions, have encouraged employers to introduce a number of initiatives aimed at developing family-friendly practices, such as the provision of child care, paid maternity leave and part-time work. Some businesses allow employees flexibility in starting and finishing times, while in others they are encouraged on some occasions to dress casually for work. Fast-tracked and made more widespread by COVID-19 workplace restrictions is having staff work from home, for those businesses for which this is practicable, for example office workers. Advances in technology through the internet and smartphones had made this increasingly possible even prior to the pandemic. See the example provided of the staff benefits offered by Westpac.

Source 14.4 There is a wide range of benefits available to attract top employees.

Employer associations

Employer associations are organisations that aim to promote the interests of employers within the business environment. They encourage governments to develop policies that enhance the interests of the employer within the employee–employer relationship. Employer associations also consult with governments on changes to key policy issues, such as trade and industry assistance schemes. Examples of employer associations in Australia are the Business Council of Australia, Employers First and the National Farmers' Federation.

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Ethical Spotlight 14.1

Employees receive an income for their work. As a result, it is expected that they will follow the instructions of their employer. What implications arise if low-skilled employees are allowed to negotiate their own wages with their employer?

Given the complex nature of federal and state government workplace **legislation**, employer associations also advise and assist members on such matters as equal employment opportunity, dismissal, wage negotiation and legislative changes.

Unions

A union (or trade union) is an organisation that aims to protect and promote the interests of employees within the workplace. Unions assist employees with disputes in the workplace and act as a bargaining agent in wage negotiations. They also advise members on workplace rights, wage levels and occupational health and safety issues. Examples of unions include the Australian Liquor, Hospitality and Miscellaneous Workers' Union; the NSW Nurses and Midwives' Association; and the Shop, Distributive and Allied Employees' Association.

Source 14.5 The Transport Workers' Union of Australia represents workers connected to the private transport industry.

Legislation Laws made by parliament.

Westpac employee benefits

Flexible working

All roles at Westpac Group are open to consider flexible working arrangements, with potential options such as flexible hours, working remotely, part time work, or job share.

Up to 12 weeks additional leave each year

We offer 12 weeks of flexible lifestyle leave giving employees the option to take up to 12 weeks' paid leave each year, through Westpac Group's purchased leave program, or 12 weeks' unpaid leave each year.

Career break leave between three and 12 months' unpaid is available for employees to refresh, re-energise, attend to other responsibilities or pursue professional development or personal interests.

A range of other leave benefits are also available for eligible employees including defence reserves leave, volunteering leave, one lifestyle and wellbeing day each

Continued →

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year, and employees transitioning to retirement can also access an additional three days' paid leave to pursue retirement related activities.

Paid parental leave

Employees who are the primary carer of their child are given 13 weeks' paid parental and have the option to instead take 26 weeks' leave at half pay. Employees who are the support carer are entitled to 2 weeks' paid leave within the first month of the birth or adoption of their child. Up to 12 months' unpaid grandparental leave is also available.

Superannuation on parental leave

Employees can apply for superannuation to be paid on up to two years' unpaid parental leave to help enhance the financial future of our working parents.

Domestic & Family Violence Support

Employees experiencing domestic and family violence can access 20 days paid leave (or more if required) as well as advice and counselling, financial support and flexible work arrangements. We also offer employees 10 days paid leave if they are supporting a family member experiencing domestic and family violence.

Leading offerings to enhance your wellbeing

We offer a range of special Westpac Group services including:

- Free nutrition advice
- Free employee counselling and coaching service for you and your family
- Access to wellbeing resources, training and development
- End of trip facilities (selected locations).

Valuable savings on banking products and services

Employees and their families can take advantage of discounts on a wide range of Westpac Group's banking and wealth products and services including when purchasing or insuring a home or a car, or saving for the future. Importantly, employees are still able to take advantage of this even after they move on from the company. In 2017, these benefits were also made available to our Contractor employees, who are now able to also take advantage of employee offers.

Third Party Partner savings

Our third party Employee Benefits Program is increasingly popular with employees and is accessible via a mobile-friendly portal, providing 24/7 access to great offers and discounts from well-known brands. With over 1.3 million logins over the past 12 months our employees clearly love the offerings.

Continued →

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Jawun Professional Secondments with Aboriginal and Torres Strait Islander communities

Westpac Group employees in Australia have a unique opportunity to participate in a life changing Jawun Professional Secondment with Aboriginal and Torres Strait Islander organisations.

Jawun is a not for profit organisation co-founded by Westpac in 2001. Jawun partners with Aboriginal and Torres Strait Islander organisations in 12 regions across Australia, providing them with skilled secondees from Jawun's 28 corporate and government partners – including Westpac Group. Secondees share their professional skills to help these organisations refine and deliver their initiatives and progress their reform agendas.

Since 2001, over 950 Westpac Group employees have taken part in Jawun secondments and success is shared both ways. The Indigenous organisations benefit from the professional skills provided by the corporate secondees, while our employees benefit from an immersive experience that builds their leadership and understanding of Indigenous cultures and ways of doing business.

Matching Gifts: matching employees' charitable donations

Matching Gifts is one of our company's best-loved community programs. Every dollar donated by our eligible employees to Australian-based, registered charities with Deductible Gift Recipient status (DGRs) is matched by Westpac Group.

Our Matching Gifts program was formed in December 1998 and was the first of its kind among Australian banks. Our Matching Gifts program creates significant value - it is a source of pride for our people; it also helps to build stronger communities by supporting charities right across Australia which deliver important social services to so many people.

Since the program began we have collectively donated over $56 million to almost 2,000 charities across Australia.

Sustainability

Our 2021-2023 Sustainability Strategy sets out how we can best serve our customers, communities and nation, and contribute to solving global challenges. Through our Sustainability Strategy we want to challenge ourselves on ways to create the most meaningful economic, social and environmental impact in the areas that matter most to our stakeholders.

Employee Action Groups

Our Employee Action Groups (EAGs) support Westpac Group's diverse and inclusive workplace culture. These employee-led networks bring passionate individuals together to advocate for and promote diverse communities both within and outside of the organisation. Our EAGs include: Women of Westpac; Cultural Diversity in Leadership; Brothers & Sisters; The Youth Network; Amplify; Veterans; Domestic & Family Violence; GLOBAL; ABLE; Pro Bono Volunteering.

Source: Westpac, 'Westpac employee benefits'.

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The national union group in Australia is the Australian Council of Trade Unions (ACTU). It lobbies the government for improved working conditions and wage increases for Australian employees. The ACTU also works with other unions in providing submissions to the Fair Work Commission for national wage case hearings.

A national wage case is one in which trade unions, employers, employer associations and the federal government provide arguments to the Fair Work Commission on the appropriate level of increase to the minimum wage.

Historically, the ACTU and federal Labor governments have worked together to improve wages and living standards. They have done this by focusing on compulsory employer-funded superannuation contributions, childcare subsidies and reduced income tax rates.

Less than one in five working Australians are trade union members. Union membership has been in steady decline since the mid-1980s.

According to a 2018 government research paper, there are several reasons for this decline, including:

- Fewer people are now employed in industries that have traditionally been strong areas of union representation. One area of historically high union membership was the public service, but a move towards private-sector organisations providing services on behalf of the government has meant that fewer people are now employed directly by government agencies and departments.
- The move from a manufacturing-based economy towards one that is service-focused has seen union representation decline because, traditionally, the service industry has not been unionised. In economics, this is known as structural change.
- A growing number of employees work on a part-time or casual basis. Fewer of these workers are likely to seek union representation compared with full-time employees. This is because the cost of joining a union is seen as quite high relative to part-time and casual weekly wages.

Video 14.1 Union membership benefits

Shop steward A union's representative in the workplace.

Award A legal document that specifies the minimum working conditions that apply to all people employed in a common industry.

A union's representative in the workplace is known as a **shop steward**. This representative acts as the first point of contact between the union and its members within a workplace. This means that the shop steward is often the first person employees speak to when a dispute arises. Union representatives often deal with minor workplace disputes and have the responsibility of referring major grievance issues to the union itself. Unions employ industrial officers to assist members with any workplace concerns they may have.

Government organisations

The government is one of the most influential stakeholders in the employment relationship process. The federal government establishes the legal framework by which employers, employees and trade unions coexist and operate within the employment relationship. It is expected that these stakeholders will follow the regulations set by the government and tribunals.

Source 14.6 Government organisations in the employment relationship

Key terms related to government's role in employment relations

It is important to develop an understanding of some key terms to assist in understanding this topic.

What is an award?

An **award** is a legal document that specifies the minimum working conditions that apply to all people employed in a common industry. It covers matters such as wages, holidays, sick leave and overtime.

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What are working conditions?

Working conditions are the non-wage features of an employee's workplace contract. These include the hours of work, rostering issues, promotional policies and occupational health and safety issues.

Source 14.7 Occupational health and safety is an important working condition.

What is a certified agreement?

A **certified agreement** is an agreement that is negotiated between an employer and all its employees. If requested, unions may assist employees in the negotiating process. Certified agreements are subject to the better off overall test. This type of wage agreement is also known as an enterprise agreement. The process of negotiating an enterprise agreement is called enterprise bargaining.

What is the better off overall test?

The better off overall test is used by the Fair Work Commission to examine whether employees will be any worse off if they sign a new wage agreement rather than being employed under an award and relevant laws.

What is an industrial dispute?

An **industrial dispute** is a problem that arises between an employer and either a group of employees or an individual employee at a workplace. The problem could concern wage rates, working conditions, occupational health and safety issues or unfair dismissal, for example.

What is conciliation?

Not all disputes can be resolved by negotiation between the employer and the employee. **Conciliation** is used when the Fair Work Commission appoints a conciliator who offers suggestions to help resolve the dispute. Although these recommendations are not legally binding, it is highly recommended that all parties to a dispute agree to them. The Fair Work Commission also assists in bringing the parties together to help reach a settlement.

Working conditions The non-wage features of an employee's workplace contract, such as hours of work and occupational health and safety issues.

Certified agreement A wage agreement that is negotiated between an employer and all its employees.

Industrial dispute A problem that arises between an employer and either a group of employees or an individual employee at a workplace.

Conciliation Process used when the Fair Work Commission offers suggestions to help resolve an industrial dispute. These recommendations are not legally binding.

Arbitration Process that involves a commissioner hearing the cases put forward by both parties in an industrial dispute and then making a decision, which is legally binding on both parties.

What is arbitration?

When the disputing parties are unable to resolve their differences through conciliation, the Fair Work Commission may decide to arbitrate on the dispute. **Arbitration** involves a commissioner hearing the cases put forward by both parties, and then making a decision that is legally binding on both parties. This process is similar to a magistrate deciding on a case heard in a court.

Fair Work Commission

Fair Work Australia, which was established in 2010 by the *Fair Work Act 2009* (Cth) (updated in 2020), became the Fair Work Commission in 2012. The Commission's primary functions are to:

- encourage the prevention and settlement of industrial disputes between employers and employees through a process of conciliation and arbitration
- determine minimum wages through national wage case hearings
- arbitrate on unfair dismissal claims where the employee believes that their dismissal was 'harsh, unjust or unreasonable'
- apply the better off overall test to certain wage agreements.

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Federal Court of Australia

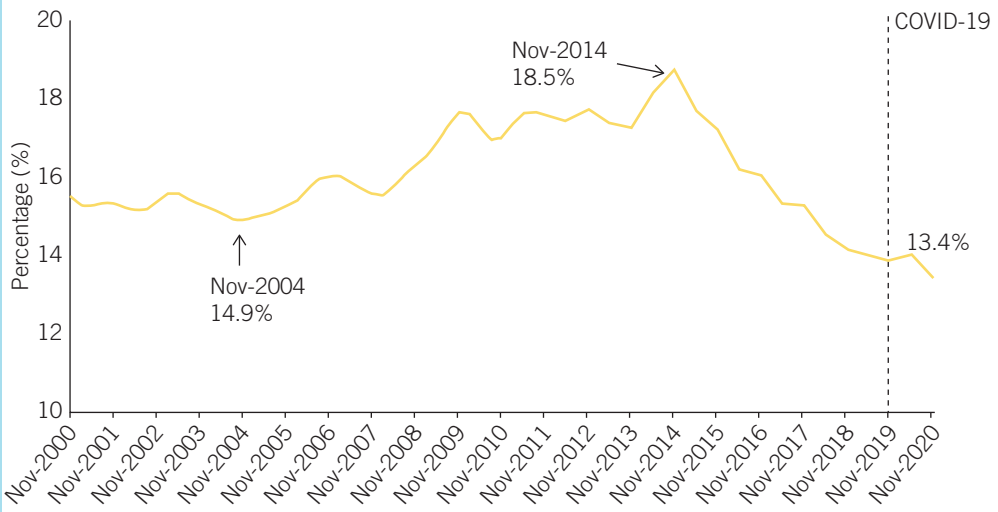
The Federal Court of Australia acts as an avenue for appeal regarding decisions made by the Fair Work Commission. It can also apply penalties to parties who breach legally binding decisions made by the Fair Work Commission.

Other agencies and organisations

The federal government is a signatory to various United Nations conventions that seek to protect the basic rights of all employees. The Australian Human Rights Commission was established in 1986 to enforce federal government legislation on discrimination in the workplace. Employees who believe they have been subjected to discrimination or sexual harassment within the workplace are able to lodge a formal complaint with the commission to seek compensation.

The other main federal government organisation dealing with workplace issues is the Workplace Gender Equality Agency (WGEA). The main responsibility of the WGEA is to promote equal opportunity for women in the workplace and administer the *Workplace Gender Equality Act 2012* (Cth).

Business Bite



Source 14.8 The Australian national gender pay gap, November 1999 to November 2019, based on full-time adult average weekly ordinary time earnings

Society

Although members of the community have no direct influence on the relationship between employers and employees within the workplace, it is becoming widely accepted that workplace practices should be reflective of behaviours that are upheld within society. Issues such as discrimination, harassment and unfair working conditions are becoming increasingly publicised. With strong media attention, businesses must clearly respond in a manner that is consistent with the view of society. For example, should employees be expected to be available outside of work hours to respond to work-related emails and phone calls?

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Business Bite

In May 2019, professional rugby player Israel Folau was found to be in breach of Rugby Australia's code of conduct, following a social media post in which he stated that gay people should repent or they would go to hell. He had previously been warned that his social media postings regarding homosexuality were incompatible with Rugby Australia's 'inclusiveness' commitment. Rugby Australia terminated Folau's contract, and he also lost a sponsorship deal with ASICS.

Source 14.9 In 2019, at a Rugby Australia media update on the future of Israel Folau, a photographer noticed this ARU history timeline which, ironically, positioned a photo of a triumphant Folau after the Wallabies' 2015 victory alongside a reference to the ARU's 2014 signing of an anti-homophobia and inclusion framework statement.

Activity 14.1
Create a mind map

Create a mind map that highlights the key stakeholders in the employment relationship and the role of each stakeholder in this relationship.

The employment relationship is subject to a considerable number of regulations and laws, as well as the involvement of various government organisations. Governments have established the legal framework by which employers and employees are encouraged to coexist cooperatively. The legal framework is a key area of the business's external environment.

Digital quiz
Please see the Interactive Textbook to access digital activities.

14.2 Legal – the current legal framework

Change is an inevitable feature of any business. It is brought about by factors within the business's internal and external environments. The changing nature of social, political and economic forces in Australia has had a considerable impact on the employment relationship. Employers and employees now coexist in an environment where the most successful businesses are those that are able to respond effectively to these changes and ensure that all those in their workforce are willing to accept and embrace the changes.

The employment contract

The employment contract is between an employer and their employee. Many of the conditions outlined in this contract are controlled by various state and federal laws, and apply to all workplaces. The growth of outsourcing and the increase in self-employment have meant that the traditional definition of an employee has changed. As discussed in Chapter 13, an employee can no longer be defined simply as an individual who offers his or her labour to a business in return for payment, but could also be an individual who acts as a consultant to business in developing effective marketing

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strategies, for example. The law regards an employee as a person who is subject to a contract of service. The employment contract is based on the employee offering his or her services on a regular basis and being subject to the lawful control and authority of the employer. The employer is able to tell the employee what job to do and how to do that job. The position of employment is ongoing and will not be terminated once a task has been completed.

An employment contract creates rights and responsibilities for employers and employees. These rights and responsibilities are enforceable by laws, such as those governing:

- a safe workplace
- minimum wage entitlements
- anti-discrimination and equal opportunity initiatives.

Source 14.10 Employment contracts create rights and responsibilities for employers and employees.

Duties of employers

Duty of care

The duty of care is one of the most important responsibilities of any employer. It refers to a business's legal obligation to provide all its employees with a safe and healthy workplace. Employees must be provided with the necessary skills, knowledge and equipment to minimise risks associated with their work within the business. The responsibility of an employer to provide a duty of care to their employees also extends to:

- warning employees of risks that may not usually arise, such as slippery floors and periods of excessive noise
- providing protective clothing.

Duty to pay the agreed wage

When an employee commences employment with a business, the business is legally obliged to pay the employee the correct legal wage. While the law allows employees to be paid more, it prohibits employees being paid less than their award wage. Employees who are employed under individual workplace contracts must be paid the amount specified in that wage agreement. The failure of the employer to do so could result in the matter being taken to the Fair Work Commission.

Duty to provide work

It is the responsibility of the employer to provide a constant source of employment to its full-time and part-time staff. Should the business not require an employee's labour, it must provide the employee with the opportunity to leave the business with financial compensation. These requirements are set out in Source 14.11.

Source 14.11 Financial entitlements for redundant employees

Years of service	Redundancy pay
1–2 years	4 weeks
2–3 years	6 weeks
3–4 years	7 weeks
Maximum payment	
9–10 years	16 weeks

These figures are based on the federal minimum standard for redundancy payment. Because a casual employee is contracted only by the hour, the employer is not obliged to provide casual employees with a constant source of work or financial compensation for loss of work.

Long service leave entitlements seek to explain the redundancy pay entitlement for employees who have a period of 10 years' continuous service or greater. Note that these are the minimum legal payments as outlined by the Fair Work Commission (refer to the Fair Work Commission website for details).

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Duties of employees

Employees also are subject to a number of legal obligations by agreeing to offer their labour to a business.

Duty to obey lawful instructions and commands

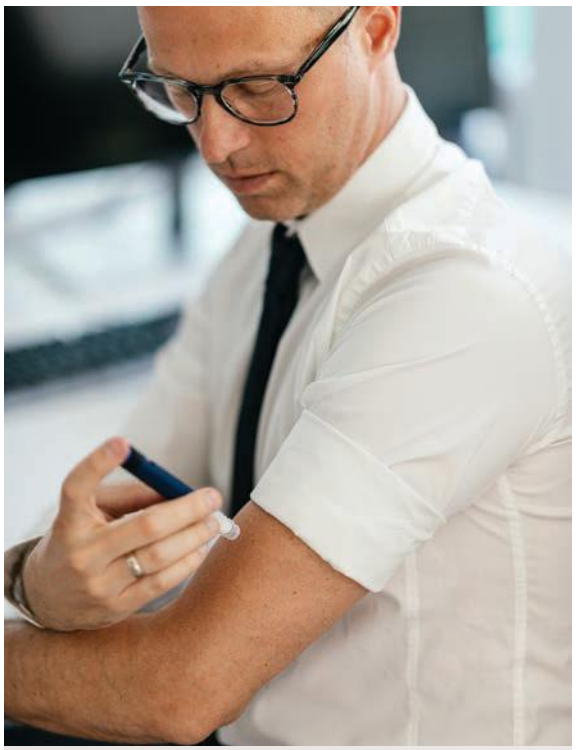
When employed by a business, the employee is expected to follow the instructions of supervisors and senior management. These instructions must be lawful (that is, employees cannot be asked to do something illegal) and should not put the employee in a position of harm or risk. The instructions must also adhere to the conditions set out in the specific wage agreement.

Duty to work with skill

When an employee is hired by a business, it is expected that the employee will perform the task to the best of his or her ability. Employees have a duty to use their skills and knowledge in a competent manner.

Duty to disclose relevant information

An employee's performance in a business may be affected by a specific medical illness or pre-existing injury. If an employer has no knowledge of relevant information about an employee's health, it may result in a serious workplace accident. It is essential that such information be disclosed to an employer as a precautionary measure. This duty raises the ethical issue of whether employees should disclose medical information about themselves that is not relevant to their position at work.



Source 14.12 Diabetes sufferer injecting insulin in the workplace. Employees have a duty to report any pre-existing injuries to their employer.

Regulating the relationship between employers and employees

Video 14.2 Government regulations governing employing staff

The employment relationship is subject to a considerable degree of government regulation. This regulation not only impacts on the method of wage negotiation and determination but also on issues affecting the day-to-day operations of the business, such as recruitment, workplace disputes and occupational health and safety. While parliament is responsible for developing these laws, it is the role of industrial tribunals and organisations to ensure that stakeholders in the employment relationship follow the rules and regulations outlined in this legislation.

Minimum wage rates

A minimum wage is an employee's minimum rate of pay for hours worked. Every year, the Fair Work Commission reviews the minimum wages that employees in the national workplace relations system receive. If there are any changes, they come into effect on 1 July. The Fair Work Commission is responsible for ensuring that employers and employees cannot agree to a rate of pay that is below the applicable minimum wage.

Who determines minimum wages?

The Fair Work Commission has a specialist panel responsible for setting minimum wages once per year. It can make changes to the minimum wages set in modern awards or a national minimum wage order.

Why does the minimum wage differ?

Minimum wages under modern awards do not just include adults. There are also minimum wage rates in place for:

- junior employees
- employees with a disability
- employees to whom training arrangements apply.

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What is the current national minimum wage?

From 1 July 2019, the federal minimum wage (before tax) is $19.49 per hour or $740.80 for a 38-hour week. The national minimum wage can also cover casual employees, who get at least a 25 per cent loading.

Source 14.13 There are minimum wage rates in place for junior employees.

Awards

An award is a legal document that outlines the minimum wages and working conditions for all employees working in a particular industry. They apply to all the businesses in that industry and remain in force until they are either varied or cancelled by agreement among employers, employees, unions and the Fair Work Commission. Awards are established through negotiations between dominant employers, employer associations and trade unions. The Fair Work Commission may assist the parties in reaching a common agreement. Under the Fair Work Act, parties to a wage agreement (usually employers, employees and unions) may apply to the Fair Work Commission to have the award changed. This allows the wage agreement to be altered to suit the individual circumstances of the business. The wages and working conditions outlined in the award variation cannot go below those outlined in the original award. The varied awards must also be approved by the Fair Work Commission.

Under current legislation, matters that may be included in an award agreement are limited. Examples include classification of employees; ordinary time hours of work; the times within which those hours of work may be performed; rest breaks and notices concerning variations to working hours; and rates of pay and classifications, including bonuses, penalty rates and redundancy payments. Such matters as limitations on the number of part-time workers, consultation with unions before dismissing employees and restructuring business operations, promotional procedures and policies are not included in the award agreement and are often subject to direct negotiation between the employer and the employee. With the introduction of wage agreements, which place greater emphasis on direct negotiation between an employer and an employee, there is greater opportunity to tailor remuneration to suit employees more appropriately. The current federal government believes that awards remain a benchmark against which the fairness of other wage agreements should be compared.

National Employment Standards

The National Employment Standards (NES) are 10 minimum standards of employment laid down in the *Fair Work Act 2009* (Cth):

1. **Maximum weekly hours of work:** 38 hours per week, plus reasonable additional hours.
2. **Requests for flexible working arrangements:** Allows employees to request flexible working arrangements if they: are the parent, or responsible for, a child who is school aged or younger; are a carer; have a disability; are 55 or older;

Continued →

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are experiencing family or domestic violence; or provide care and support to a member of their household or immediate family who requires care and support because of family or domestic violence.

3. **Parental leave and related entitlements:** Up to 12 months' unpaid leave for every employee, plus a right to request an additional 12 months' unpaid leave, plus other forms of maternity, paternity and adoption-related leave.
4. **Annual leave:** Four weeks' paid leave per year, plus an additional week for certain shift workers.
5. **Personal/carer's leave, compassionate leave and unpaid family and domestic violence leave:** 10 days' paid personal/carer's leave per year, two days' unpaid carer's leave as required, two days' compassionate leave (unpaid for casuals) as required and five days' unpaid family and domestic violence leave per year.
6. **Community service leave:** Unpaid leave for voluntary emergency activities and leave for jury service, with an entitlement to be paid for up to 10 days for jury service.
7. **Long service leave:** A transitional entitlement for certain employees who had certain LSL entitlements before 1 January 2010 pending the development of a uniform national long service leave standard.
8. **Public holidays:** A paid day off on a public holiday, except where reasonably requested to work.
9. **Notice of termination and redundancy pay:** Up to four weeks' notice of termination (five weeks if the employee is over 45 and has at least two years of continuous service) and up to 16 weeks' redundancy pay, both based on length of service.
10. **Provision of a Fair Work Information Statement:** Employers must provide this statement to all new employees. It contains information about the NES, modern awards, agreement-making, the right to freedom of association, termination of employment, individual flexibility arrangements, rights of entry and the respective roles of the Fair Work Commission and the Fair Work Ombudsman.

Source: Fair Work Ombudsman.

Agreements

In 1991, the federal government sought to encourage workplaces to develop their own wage agreements. This has meant a move away from a system where wage rates and working conditions are determined by a central government authority to a system that aims to meet the needs of individual businesses and their employees. This change was to help businesses improve their operations and reduce costs and to help employees negotiate more flexible working conditions. Such wage agreements include certified agreements and Australian workplace agreements.

Certified agreements

Certified agreements, which are also known as enterprise agreements, are exclusive to a business and its employees. Unions may be involved in the negotiation of these agreements. Alternatively,

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employees may form their own work-based committees to represent staff in the negotiations. The agreement must be approved by a majority of staff, and employers must in no way have forced employees to accept the terms and conditions of the new agreement. Once an agreement has been negotiated, it will be presented to the Fair Work Commission for approval. The Fair Work Commission will determine whether the employees are either better or worse off by moving to this new agreement. The award that covers this business will be used as the benchmark for comparison. The process conducted by the Fair Work Commission is referred to as the better off overall test. If the Fair Work Commission believes that employees will be disadvantaged by the new terms and conditions, then the agreement will not be passed.

Activity 14.2
Role-play

Benjamin has been asked by his employer, LexDex, to consider signing an enterprise agreement. As his union adviser, explain to Benjamin what an enterprise agreement is, outlining the role of the Fair Work Commission in relation to these agreements.

Types of employment contracts

Most Australian employees are still on one of four types of employment contract:

- part-time
- permanent
- casual
- fixed-term.

Part-time employment

Part-time work involves an employee working a fixed set of hours per week, but usually less than those of a full-time employee. They may choose to work additional hours each week. Part-time employees are entitled to all the benefits of full-time staff, including sick and annual leave, holiday loading and various meal and uniform allowances. These are provided on a pro rata basis: a part-time employee receives a portion of the benefits based on the proportion of hours they work compared with a full-time employee. So, for example, a part-time employee who works three-quarters of the hours a full-time employee works would only receive three-quarters of the annual leave entitlement.

Permanent employment

A permanent employee is a person who is provided with continuing employment within the organisation. Permanent employees work between 35 and 40 hours per week (depending on their wage agreement) and may be requested to work more hours than this. In some cases, if they are required to work beyond the specified ordinary time hours, they will be paid an overtime allowance as outlined in their wage agreement. Permanent full-time employees are entitled to a minimum of four weeks of holidays per year and receive 2 months of long service leave after working for 10 years with the same employer.

Source 14.14 Permanent employees are entitled to many benefits.

Casual employment

Casual employees are employed by a business for short periods of time. They must work for a minimum of between one and three shifts. The regularity of their employment is subject to the employer's demands. The employer is not obliged to provide regular, ongoing work. As casual employees do not receive holiday or sick leave entitlements, they are entitled to be paid up to 15 to 20 per cent more than the wage paid to a full-time, permanent employee doing the same type of work.

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Activity 14.3
Comprehension

1 Explain why a business may choose to employ staff on a casual basis.
2 Naomi is a part-time employee of AXAR Advertising. Explain how her entitlements will differ from those of her colleague Juan, who is a full-time employee.

Fixed-term contracts

Fixed-term contracts are used by businesses that require the use of labour for only a specific period of time. Both parties are in agreement to this time period and the contract can only be altered with the consent of both parties. Should the employer seek to terminate the contract against the wishes of the employee, it is known as a breach of contract. In such a situation, the employee has the right to pursue court action to recover lost income earnings. Similarly, employers may seek legal compensation if the contractor did not perform the task that the employer paid the contractor to do.

Occupational health and safety and workers compensation

Work Health and Safety Act

Statistics show that each day one person in Australia dies from a work-related injury. The safety of employees within the workplace is of paramount concern to federal and state governments. The *Work Health and Safety Act 2011* (NSW), for example, establishes the rights and responsibilities of employers and employees in regard to safety in the workplace within New South Wales. Employers must provide staff with a safe workplace and seek to minimise any potential risk that may arise. Businesses with more than 20 employees must have an occupational health and safety committee. The aim of these committees is to address any work-related health or safety concerns employees may have. While there is a considerable burden of responsibility on employers, employees must also cooperate in maintaining safety in the workplace.

Workers Compensation Act and Workplace Injury Management and Workers Compensation Act

In New South Wales, the *Workers Compensation Act 1987* (NSW) and the *Workplace Injury Management and Workers Compensation Act 1998* (NSW) govern the process of employees gaining financial compensation for injuries sustained at work and their subsequent return to work. The aim of this legislation is to maintain the income of the injured employee and ensure that, once rehabilitated, the employee is able to return to work in some capacity. All states and territories have similar legislation.

Source 14.15 Workers injured at work are entitled to compensation and support.

Anti-discrimination legislation

Various anti-discrimination laws prohibit discrimination in the workplace on the grounds of gender, ethnicity, sexual preference, religion or disability. This legislation includes the *Sex Discrimination Act 1984* (Cth), the *Racial Discrimination Act 1975* (Cth), the *Australian Human Rights Commission Act 1986* (Cth) and the *Disability Discrimination Act 1992* (Cth). In early 2017, there was a proposal to change some of the terms in the Racial Discrimination Act, but this was defeated in the Senate.

The Australian Human Rights Commission enforces anti-discrimination legislation. While

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such legislation exists to protect the interests of the employee, it is the responsibility of the employee to report instances of discrimination. Fear, intimidation and harassment could discourage an employee from lodging a formal complaint with the Australian Human Rights Commission.

Business Bite

Jenny, 54, was employed by a small retail firm as a full-time sales assistant. She was dismissed after the business was taken over by a new owner. The owner claimed this was because Jenny was 'too expensive to keep on'. Soon after Jenny's dismissal the company advertised for a full-time junior sales assistant. The company denied age was a factor in Jenny's dismissal.

The Commission held phone discussions with Jenny and the company. The company agreed to pay her three weeks' wages as compensation.

Source: Australian Human Rights Commission.

Digital quiz
Please see the Interactive Textbook to access digital activities.

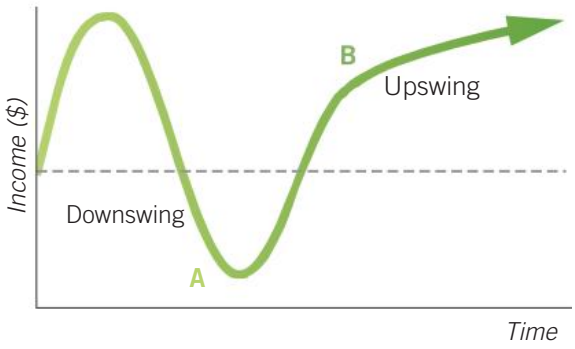
Activity 14.4
Summarise

Construct a summary table outlining the differences between federal and state government workplace legislation.

14.3 Economic
The economic cycle

The significance of a business to an economy cannot be understated. Petrol is to a car as business is to the economy. Business is the fuel that drives production, price changes, employment and our standard of living. The level of economic activity is primarily determined by the level of consumer and business spending within a given period of time and is a significant influence on the demand for employees. As an economy grows in the upswing stage, businesses will need more employees to create goods and services. The level of consumption and business investment changes over time. These fluctuations in consumer and business spending are, collectively, known as the economic cycle.

Employment is a fundamental cornerstone of any economy. If employees are confident about their job security, they have an increased willingness to spend more of their income on consumer goods.



Source 14.16 The economic cycle

This increased spending encourages business to demand more labour as a means of producing more goods and services. Often, the main reason why more goods and services are produced is that consumer demand has increased. This is commonly referred to as economic growth. High employment will generally result in increased consumer spending.

This has a positive effect on business, as increased revenue will often translate into higher profits. At some point, however, the government will attempt to ensure that this level of growth is sustainable and will not lead to other economic problems, such as inflation. This leads to a peak followed by the downswing stage: recession starts and employment rates fall.

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The impact of inflation

How does inflation impact on the employment relations function of business? Consider the following scenario. Consumer confidence in an economy is growing. This is reflected by an increase in consumer spending. As demand for goods and services increases, businesses react by increasing their levels of output and production. Some goods may take longer to produce.

The demand for these products may see consumers become willing to pay a higher price for them. As prices rise, the cost of living increases. During periods of wage negotiations, employees will seek higher wages from their employer to compensate for this increase. Higher wages inevitably increase the costs of production of any business. This could result in a business reducing the size of its workforce, with the remaining staff carrying an additional workload, and increasing the unemployment rate in that economy.

Globalisation

Globalisation refers to the integration of the world's economies into a single market where goods and services can be traded with ease. Over the past 20 years, Australian businesses have faced increased competition from foreign businesses. Many of the clothes we wear are made in foreign countries and many of the products we use are produced and supplied by large, foreign-owned businesses. The government has encouraged foreign-owned businesses to establish their operations in Australia to provide consumers with greater choice and lower prices. While these businesses often employ Australian staff, the impact of this increased competition has seen many Australian-owned businesses suffer.

Unable to compete with lower prices, some Australian-owned businesses have ceased operations and, as a result, their employees have lost their jobs. The closure of Australian businesses also leads to retrenchments. Workers are **retrenched** when their services are no longer needed because the business they work for has downsized, closed a division or outsourced a function and therefore requires fewer workers. From an employment relations perspective, it is important for a business to follow the correct procedures in ensuring that employees receive their legal entitlements and correct pay if they are retrenched.

Source 14.17 Globalisation has led to the closure of local businesses.

Retrenched Workers are retrenched when their services are no longer needed because the business they work for has downsized, closed a division or outsourced a function and therefore requires fewer workers.

The multicultural nature of Australia's workforce is a direct consequence of globalisation. Many overseas citizens have come to Australia hoping to utilise and develop their skills and provide themselves and their families with improved opportunities.

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Business Bite

India is fast becoming the call centre capital of the world. More than 30 per cent of Indian university graduates are unable to find work each year. They are attracted to work at call centres, which pay above-average annual incomes of between AUD $3000 and $5000. Leading global economic forecaster, the London-based Economist Intelligence Unit, estimates the average annual income in India to be US$655. This is very low compared to the average annual income in Australia, making it more cost-effective for an Australian business to divert its call centre function from Australia to India. The call centre representatives in India are trained in Australian figures of speech and provided with information about Australian customs and culture. While this practice is legal, the ethics surrounding it are questionable.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Activity 14.5
Discussion

Refer to the graph in Source 14.16 on page 320. An economy is currently at point **A** in the economic cycle. As the economy moves to point **B**, discuss how this would impact on the size of a business's workforce.

Ethical Spotlight 14.2

While profit is important, a business should also consider its responsibilities to its employees. Therefore, Australian businesses should protect the interests of the Australian labour force by refusing to produce goods and services in low-cost labour countries. To what extent do you agree with this view? Explain your answer.

14.4 Technological

The growing influence of technology over all aspects of business operations has become much clearer in recent times. While technology seeks to improve the quality of products and the efficiency with which they have been produced, its impact upon the labour force has been subject to considerable debate.

Positive impacts of technology on human resources are:

- it allows the business to develop more efficient production techniques
- employees can be up-skilled in the use of new workplace technologies
- it encourages the employee to deliver the product/service in new and improved ways
- it fosters a process of continued learning within an organisation
- it reduces the repetitive nature of labour-intensive work
- it fosters teamwork whereby staff become mentors to colleagues through the process of learning the new technologies.

Negative impacts of technology on human resources are:

- the loss of employment as technology itself becomes the main tool of production
- employee resistance to change as the workforce becomes reluctant to learn new technologies
- reduced employee morale as the workforce feels their positions are less valued due to the growing importance of technology
- lower levels of employee empowerment and decision-making as technology becomes a key driver in production methods.

While consumers seek products that feature innovation, the impact of technology in

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the Australian manufacturing sector raises a concern. Recent data compiled by the Australian Bureau of Statistics shows that employment in the manufacturing industry is in decline. The growth of technology across these industries has no doubt facilitated the downward trend.

Source 14.18 Technology has had both positive and negative consequences on human resources.

14.5 Social

Modern Australian workplaces are characterised by greater diversity in the ethnic and cultural backgrounds of the workforce, the increased participation of women in the workforce and the desire by many employees to achieve a balance between work and family. Social influences such as these impact on the methods by which a business plans, organises and implements its employment relations functions.

Changing work patterns

The way in which Australians work has changed considerably over the past 10 years. Women now account for a greater proportion of the Australian workforce than ever before. Despite this, women are underrepresented on the boards of directors of Australia's leading businesses.

According to Ruth Medd, Chair of the Women on Boards program, 'This means that women are underrepresented in positions of power and influence in Australia. And more importantly it means that as a consequence Australia is failing to reach its full potential' (Women on Boards website).

The increased participation of women in the workforce has coincided with growth in part-time and casual work. With increased growth in the retail, hospitality and education sectors, more Australians, including women, have the opportunity to enjoy the flexibility of part-time or casual employment. Technological developments have facilitated the considerable decline in employment in Australia's manufacturing sector. There are fewer unskilled jobs available within the market, and businesses are more willing to introduce low-cost technological production methods at the expense of labour. The traditional hours of work from 9 a.m. to 5 p.m. have also begun to disappear. Many businesses operate beyond these hours and allow consumers access to their products and services seven days a week.

The changes to retail shopping hours, the growth of the hospitality sector and the emergence of call centres have seen a considerable increase in the number of employees working outside the traditional hours and on weekends. Employees traditionally received a higher pay rate – known as penalty rates – when working on weekends or public holidays. In 2017, the Fair Work Commission announced reductions to some penalty rates for retail and hospitality workers. On 1 July 2017, there was a reduction of the public holiday rate and a partial reduction of the Sunday rate. As more businesses operate across extended trading hours seven days a week, there has been a push to have penalty rates scrapped in return for a higher hourly rate.

Living standards

Education is undeniably a key factor influencing an individual's occupation. Less educated people who lack skills and qualifications may often be employed in industries with wage rates that are considered to be low. Many might be afraid to challenge their employers on their wages and conditions for fear of losing their jobs. Many of these jobs, such as factory-type jobs, are low-skilled and therefore do not have a lot of power attached to them. As a result, there is an emerging disparity between living standards across the community.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Digital quiz
Please see the Interactive Textbook to access digital activities.

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14.6 Ethics and corporate social responsibility

Corporate social responsibility (CSR) is defined by the World Business Council for Sustainable Development as 'the continuing commitment by companies to behave ethically and to contribute to economic development, while improving the quality of life of the workforce and their families, as well as the local community and society at large'.

It is being recognised among the business community that being a good corporate citizen is about a company making lasting contributions to the community. This encourages businesses to consider social, economic and environmental concerns in its operations and decision-making. While shareholders are a key aspect of the business, it must also consider the interests of other people who affect, or are affected by, the business. These stakeholders include employees, customers, suppliers, community organisations and local communities.

The key to a business successfully demonstrating its commitment to CSR is ultimately through its actions. A business can do this by:

- supporting community projects
- funding research
- establishing occupational health and safety measures
- maintaining environmentally friendly practices
- providing support (e.g. counselling) to employees who need it
- having a code of ethics that applies to all business operations.

Some examples

In June 2018, both Woolworths and Coles ceased providing single-use plastic bags for shoppers. Customers are encouraged to bring their own bags, although both chains offer more durable, reusable bags at a small cost. A number of other businesses have done the same (e.g. Bakers Delight, Noni B). In 2020, the NSW Government announced its intention to join all other Australian states and territories in banning the supply of single-use plastic bags to consumers.

Telstra encourages employees to get involved with communities and causes of their choice. Through Telstra's volunteering program called 'One Day. One Cause. For Everyone', each employee gets one day of paid volunteering leave. In addition, Telstra facilitates its staff to be active blood donors with the Australian Red Cross Blood Service by giving them paid blood donor leave.

Ronald McDonald House Charities focuses on providing facilities and support for seriously ill children, to help them have a 'brighter, happier and healthier' life.

Business Bite

STREAT is a Melbourne-based company that is combating youth homelessness within the community. Rebecca Scott and her partner Kate Barrelle opened a food cart in Federation Square in the heart of Melbourne with the aim of helping young homeless people and disadvantaged youths find training and work. The corporation has now expanded into eight interconnected businesses and has helped to train and support over 500 young people.

STREAT has a 'range of strategic goals in four key impact areas: People, Planet, Profit and Performance … to ensure we minimise our environmental footprint whilst trying to maximise our social footprint'. Produce, packaging and printing, energy, buildings, transport, cleaning and waste are all outlined on STREAT's website as being sourced, constructed and delivered in ethically and socially responsible ways.

Continued →

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Source 14.19 STREAT is a hospitality-based social enterprise that provides supported vocational training and holistic personal support to marginalised and disadvantaged young people in Melbourne.

Corporate social responsibility and human resources

An effective corporate social responsibility program will impact upon the human resource function of a business. It enhances the reputation and standing of the business within the community and may be used to promote recruitment of staff for the business.

According to Sarah Stawiski from the Center for Creative Leadership, in her report on the World Leadership Study, a strong program in corporate social responsibility is not likely to make an unhappy employee a happy one and won't reduce staff turnover. She adds, however, that it can influence how employees view their organisation and how they see themselves as ambassadors for it.

Strategies to promote corporate social responsibility within a workforce include:

- promoting effective affirmative action and anti-discrimination programs within the workplace
- developing initiatives that reduce the business's impact upon the environment
- engaging in strategies that promote work–life balance and enhance workplace flexibility
- encouraging staff to volunteer their time to participate in community-building activities.

Source 14.20 Switching to more environmentally friendly practices is an act of corporate social responsibility.

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Business Bite

Crown is one of Australia's largest casino groups. It has been recognised for its commitment to promoting the employment prospects of First Nations peoples.

Through its commitment to making a difference to the lives of individuals by providing training and employment opportunities in the growing tourism industry, Crown has now provided employment for more than 450 Aboriginal and Torres Strait Islander peoples. The Indigenous Employment Program offers more than just a job – it aims to provide a strong support network as well as an individual career development plan to help employees identify their career aspirations, and give them the necessary training and support required to help achieve them. More than 1600 hours invested to training and developing will create an advantage at all levels of the business, leading to the goal of Crown being a true equal-opportunity employer.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Activity 14.6
Report writing

Chalmers is one of the country's leading department stores. Management has decided to pursue a more active role in developing initiatives that promote corporate social responsibility. Write a report on methods of promoting the interests of human resources within the business.

Chapter summary

The six stakeholders in the employment relationship are employees, employers, unions, employer associations, government organisations and society.

An employer is an individual or organisation that pays others to work for their business. The employer could be the owner of the business or, as is the case with larger businesses, a team of managers.

Human resource departments are specialist departments that manage the employment relations function of a business.

An employee is an individual who provides his or her skills to an organisation on a regular basis in return for an income.

Many businesses now provide employees with non-financial rewards to encourage greater motivation and effort. Such rewards include a role in the firm's decision-making process and flexibility in starting and finishing times.

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Employer associations are organisations that aim to promote the interests of employers within the business environment. They do this by providing employers with advice on legal matters related to the employment relationship and by lobbying governments on issues affecting employers within the business environment.

A union is an organisation that aims to protect and promote the interests of employees within the workplace. They assist employees in resolving disputes and act as bargaining agents in wage negotiations.

The government is one of the most influential stakeholders in the employment relationship. The key government organisations involved in this relationship are the:
- Fair Work Commission
- Australian Human Rights Commission
- Workplace Gender Equality Agency.

A contract of service is based on the employee offering his or her services to an organisation on a regular basis and being subject to the lawful control and authority of the employer.

All employers have a duty of care to their employees. They must provide their staff with a safe working environment. It is also the legal responsibility of an employer to ensure that staff members receive the correct wage and other entitlements.

Corporate social responsibility (CSR) refers to the continuing commitment by companies to behave ethically and to contribute to economic development, while improving the quality of life of the workforce and their families, as well as the local community and society at large.

Key pieces of employment legislation include the:
- *Fair Work Act 2009* (Cth)
- *Work Health and Safety Act 2011* (NSW)
- *Workers Compensation Act 1987* (NSW)
- *Racial Discrimination Act 1975* (Cth)
- *Sex Discrimination Act 1984* (Cth)
- *Australian Human Rights Commission Act 1986* (Cth)
- *Anti-Discrimination Act 1977* (NSW).

An award is a legal document that outlines the minimum wages and working conditions of all employees based on their work in a certain industry.

Certified agreements are also known as enterprise agreements. They involve only one employer and its employees. These agreements must be examined and passed by the Fair Work Commission before coming into effect.

Certified agreements are subject to the better off overall test, ensuring employees are not worse off by signing the new wage agreement.

There are four types of employment contract:
- part-time
- permanent
- casual
- fixed-term.

The economy has a significant influence on employment relations. A strong economy is characterised by high consumer spending and increased sales. This can lead to increased levels of employment.

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The growth of foreign businesses operating in Australia has encouraged many Australian businesses to become more efficient and competitive. They have done this by reducing costs, lowering prices and increasing their product range.

The advance of technology in the manufacturing sector has seen many businesses reduce the size of their workforce and encourage existing staff to broaden their range of skills.

Social changes are brought about through changes in society. Influences in the employment relationship relate to the changing work patterns of Australians, such as the increased participation of women in the workforce and the growth of part-time and casual work.

Employees are required to obey the lawful instructions of employers. They must work to the best of their ability and disclose any relevant information that may impact on the performance of their work.

End-of-chapter tasks

Chapter revision task

Describe the role of each stakeholder in the human resource relationship and examine how influences on human resources affect these stakeholders.

Multiple-choice questions

1 The government is introducing a new law involving the relationship between an employer and an employee.

Which influence would this be an example of?

A Legal
B Social
C Economic
D Behavioural

2 The decline of unskilled jobs in the Australian economy has been caused by which of the following factors?

A Globalisation, as Australia's international competitors have lower labour costs
B Economic, as Australia is currently experiencing a downturn
C Globalisation, as other countries are able to supply more skilled resources to Australian businesses
D Economic, due to the high minimum wage rates in Australia compared to other countries

3 A downturn in consumer confidence and spending is reflective of which influence on employment relations?

A Social
B Economic
C Legal
D New organisational behavioural

4 How is an economy with low interest rates, increased consumer spending and higher output levels likely to impact on the employment relations process?

A Increase employment opportunities
B Increase business profit
C Increase labour productivity levels
D Increase the occurrence of industrial disputes

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5 Which of the following is an impact of changing social influences on the Australian economy?

A The need to develop a cost-efficient and competitive labour force
B The ability to extend recruitment practices to foreign countries
C The need to achieve a culturally diverse workforce
D The ability to access a greater range of raw materials and supplies

6 Growth in employment, wages and inflation is likely to occur during which stage of the business cycle?

A Expansion
B Boom
C Downswing
D Recession

7 What is the key piece of federal government legislation regulating the employment relationship?

A *Work Health and Safety Act 2011* (NSW)
B *Australian Human Rights Commission Act 1986* (Cth)
C *Workplace Relations Act 1996* (Cth)
D *Fair Work Act 2009* (Cth)

8 Under the *Work Health and Safety Act 2011* (NSW), which two stakeholders share the key responsibility of providing a workplace that is safe and healthy for all parties?

A Employees and employers
B Employers and the government
C Unions and government tribunals
D Employer associations and society

9 Which of the following is an example of a business promoting its role as a socially responsible corporate citizen?

A The rostering of staff over a 24-hour shift
B Providing staff with Christmas gifts
C Encouraging staff to volunteer to assist with a local charity
D Higher prices for products that do not promote healthy eating

10 How does an effective corporate social responsibility program benefit the human resource function of a business?

A Promotes the reputation of the business
B Increases customer awareness of the business
C Promotes profitability within the business
D Reduces costs within the business

Short-answer questions

1 Examine the impact of changing economic conditions on the demand for labour across Australian businesses.

2 List and describe three pieces of government legislation aimed at promoting a workforce that is more tolerant of differences.

Extended-response question

Examine the impact of globalisation and social influences on the relationship between employers and employees within a firm.

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15 Processes of human resource management

Chapter objectives

In this chapter, students will:

- investigate, analyse and evaluate the processes of human resource management.

Key terms

- acquisition
- database
- deregulation
- human resource cycle
- induction
- intrinsic reward
- involuntary separation
- maintenance
- merger
- non-monetary benefits
- performance appraisal
- recruit
- salary
- selection
- separation
- staff turnover
- takeover
- training
- wage

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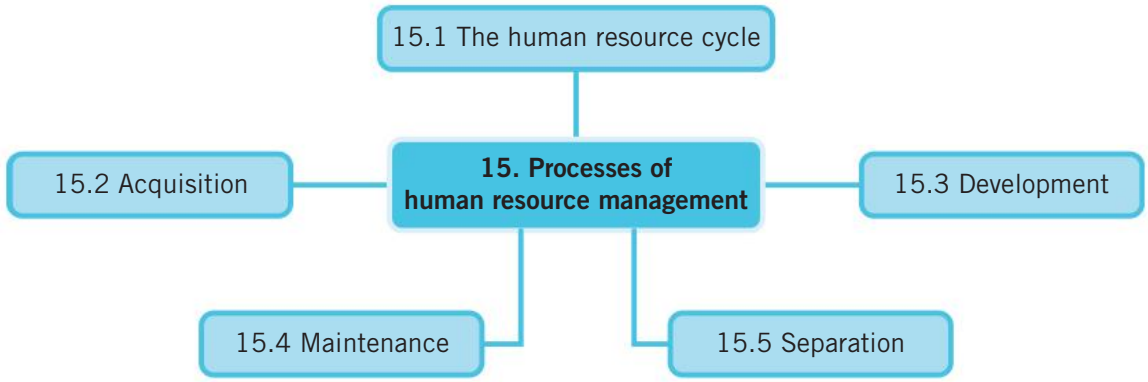
15.0 Introduction



Source 15.1 Processes of human resource management concept map

The staff of a business have become a valuable asset in an environment where the global availability of technology, machinery and raw materials has levelled the playing field for businesses. The service, skills, talents and expertise of the business's workforce are real components that can provide the firm with a competitive advantage over other businesses. The role of employment relations is to provide the business with the workforce that it requires. It is the support function that aims to find, attract, develop and motivate the people who can provide the services the business needs. This human element, the staff of the business, must be maintained and sufficiently motivated to give the business a competitive edge.

Employment relations can be defined as the function that deals specifically with the relationships between the employer and the employees of the business. Employment relations managers are also known as human resource managers. Employment relations managers are increasingly aware that employees' satisfaction with their employment often reflects on productivity and efficiency within a business. This relationship increases substantially when employees are given responsibility for making decisions that affect the manner in which they do their jobs. In the past, the people who worked in the human resource management (HRM) department of a business were seen as not adding value to the product or to the business's profitability and were often the first to be retrenched when cost-cutting was needed.

Today, however, the value of a high-quality HRM system is seen as a major component of a business's success. As a response to the growing importance placed on the human factor, the federal and state governments have passed many laws covering employment relations issues, including equal employment opportunity, anti-discrimination and occupational health and safety. Businesses must comply with these laws.

Digital quiz Please see the Interactive Textbook to access digital activities.

15.1 The human resource cycle

The work of the employment relations manager is ongoing. It involves a continuous **human resource cycle**, which involves acquiring people with skills for the job and the continued development of employees' knowledge and capabilities. When employees leave the business, replacements must be acquired.

Digital quiz Please see the Interactive Textbook to access digital activities.

The cycle also involves providing incentives for effective, reliable employees to remain motivated and stay with the business as well as setting up procedures for the removal of staff whose skills and attitudes are no longer relevant to the business.

Human resource cycle The cycle of acquisition, development, maintenance and separation of employees.

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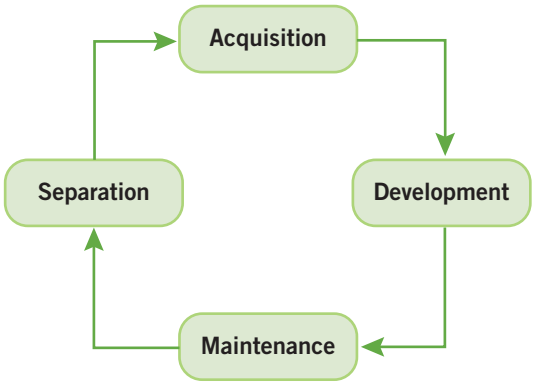

Source 15.2 The human resource cycle

15.2 Acquisition

Human resource planning includes strategies that meet the needs of the business today as well as in the future. The firm will have established its goals, and the human resource department will examine whether it has the appropriate staff to meet the firm's needs. In order to do this effectively, the business needs to:

- identify the skills and number of employees required in the future – the department needs to take into account any changes the business is introducing (for example, new technology), the strategies the business has chosen to follow and its goals (such as expansion to other geographic areas)
- analyse its existing workforce – the department can check through the employee information on its database to identify skills, training and even hobbies and special interests that can be utilised by the business
- compare the expected future needs of the business with the existing supply of staff.

These activities will assist the HRM department to relate present and future staffing needs to the business's existing workforce. The firm can then determine if there is a need to hire additional staff.

Acquisition is the stage in the human resource cycle that involves:

- identifying staffing needs
- recruitment
- selection.

Acquisition The stage in the human resource cycle that involves staffing needs, recruitment and selection.

Identifying staffing needs

Identifying staffing needs is not as simple as employing more people. It is possible that the existing workforce may not be working to its potential. It may simply involve training existing staff to make them more able to cope with the changes that will be introduced or providing staff with an incentive program to entice them to be more productive and efficient. If this is not the case and more employees are needed, then the specific job needs to be identified and analysed. This will result in a job description, which is a written statement describing the duties, tasks and responsibilities associated with the job. It is an outline of what the employer expects the employee to do within the role. After this, a job specification is developed. It outlines the key skills, experience and qualifications needed for this particular job. The job description decides the actual tasks involved in doing the job. The job specification determines the skills, qualifications and expertise needed to do the tasks. The employment relations department will need to work closely with the other functional departments to determine this information. In the function of operations, for example, a welder may be needed on the factory floor. The job description and job specification for the welder would be developed with the operations department. In order to acquire a new member of staff, the value of the job needs to be established and a remuneration figure attached. This involves determining how much the job is worth (that is, the pay and entitlements that will be provided to the person employed to do the job). Much of this will depend on conditions that have been established in the legal wage agreements with which the business must comply.

Classification of employees

There are several different types of employee. Some of the main forms of classification are:

- casual
- part-time
- full-time.

Casual workers are hired on an hourly or daily basis. They do not receive benefits such as sick leave, and because of this their pay rate is higher than the normal rate. This loading could be between 15 per cent and 33 per cent above the normal hourly rate for full-time workers, and varies across occupations.

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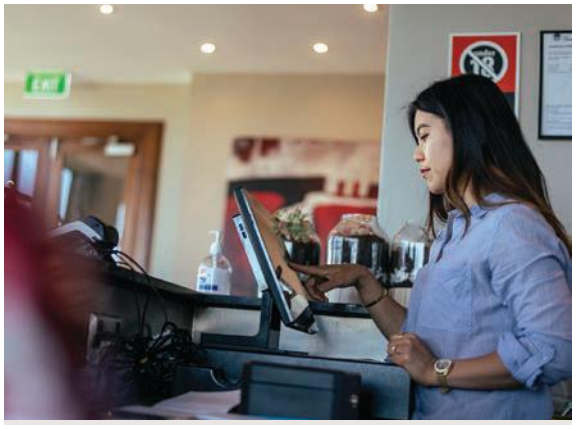

Source 15.3 Part-time employees are hired to work a regular number of hours per week.

Part-time employees work a regular number of hours per week, but fewer than full-time hours. Part-time workers usually receive the flat hourly rate of full-time workers and are entitled to benefits on a pro rata, or proportional, basis. For example, if an employee works one-fifth of the load of a full-time worker, they are entitled to one-fifth of the entitlements of the full-time worker.

Full-time employees receive full weekly wages and conditions and may work between 35 and 40 hours or, on average, 38 hours per week depending on their occupation and award. Workers may also be classified as:

- on probation
- temporary.

Workers are often hired and given a probationary period of approximately three to 12 months to 'prove' themselves before they are made permanent. This gives the employer time to evaluate the employee's ability to fulfil the needs of the business. Temporary workers are those employed for short periods of time to replace an absent worker. This could be for one day or several months.

Ethical Spotlight 15.1

It is possible for a firm to act unethically by employing workers on probation, knowing that it expects to dismiss the workers when the firm's workload decreases. Most employees on probation would assume that they have a chance of achieving a secure employment position.

Recruitment

The business can fill a vacancy by **recruiting** applicants:

- **internally** – from existing staff
- **externally** – from outside the business.

Recruit To accumulate a pool of potential candidates for a job. It is from this pool that the business must make its selection.

Businesses may look within the business to fill positions. This could involve a promotion for an existing staff member who has applied for the job and whose success would depend on merit, expertise and ability. This also provides an incentive for other staff to improve their performance, as promotion would be seen as a reward for hard work. This method of recruitment can cause problems if other staff members feel that the person did not deserve the promotion. A promotion may create a need to fill the place of the promoted employee.

If the position cannot be filled from internal sources, then the business can advertise externally for job applicants. There are various methods available to do this, including the following:

- The recruitment function can be outsourced to private employment agencies – specialist recruitment firms who look after advertising and creating shortlists of candidates.
- Students or graduates may be recruited through interviews on university campuses, often targeting the top achievers in specific courses. This method is popular with some larger firms.
- Trainee positions may be offered to HSC students to complete 'cadetship' courses. These courses allow students to complete their academic qualifications while having a paid job with a reputable firm. The firm could provide these employees with practical knowledge and also assist them with their academic studies. Many accounting or law firms use this method of recruitment.
- Online career sites can be used. These sites are increasingly popular in recruitment.
- The position can be advertised in the job vacancy sections of local or major newspapers.
- The federal government agency Centrelink can be used. It offers a range of services to the community, including business and employer information.

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Source 15.4 More than 80 per cent of younger jobseekers use social media in their job search.

- Current staff may be consulted to establish whether they know any people who are suitable for the job, such as family members, friends or acquaintances.
- At times, businesses may 'poach' or 'headhunt' employees from their competitors by offering them a better remuneration package.

Applicants would apply for the advertised job by a specific date and provide a resumé outlining personal information, such as employment history, skills and qualifications. The main aim of recruiting is to accumulate a pool of potential candidates for a job. It is from this pool that the business must make its selection.

Halligan

Considering your career?

Halligan Accountancy and Finance Open Night

Thursday 3 December 5–9 p.m.

Halligan Accountancy and Finance are Australia's leading recruiters of finance professionals, accountants and accounting support staff, and are the favoured recruitment agency for some of Australia's largest and most influential organisations.

We are currently recruiting a variety of finance and accounting roles across Sydney and the surrounding suburbs, and will be holding discussions on your career path and vacant positions at all of our various Sydney branches on Thursday 3 December.

Our Finance Support Division is currently seeking applicants for the following roles across Sydney:

Accounts Clerk Accounts Payable Accounts Receivable Bookkeeping Credit Controller

Assistant Accountants Payroll Accounts Supervisors

For a further discussion and to make a confidential appointment please contact the office most convenient to you:

Burwood 9744 1333
Chatswood 9411 3388
Liverpool 9601 7865
Parramatta 9635 4211
City South 9280 7689
Hurstville 9580 9900
North Sydney 9957 6522
Sydney 8226 7888

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Source 15.5 Job vacancies can be advertised through employment agencies.

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Business Bite

Source 15.6 Maile (pronounced Miley) Carnegie is one of Australia's most respected and regarded executive managers.

A former head of Google Australia, Maile Carnegie was paid more than $4 million in a combination of cash and shares to join ANZ in 2017. The reason for this amount is that Carnegie would have been entitled to this money had she stayed with Google and earned a performance bonus. To encourage her to move businesses, ANZ offered to cover any losses she would experience.

Activity 15.1
Research

Conduct newspaper and internet research to complete the following tasks. In each case, try to establish the types of people the business is looking for. This may include skills and qualifications needed and may also relate to age, pay, location and hours of work.

1 Identify jobs available in the specific area of work in which you are interested. The job should be geographically accessible to you and suitable for your current age group.
2 Identify jobs available in the broader areas of your professional interest.

Selection

Selection is a screening process. The information gathered about job applicants is reviewed and the most appropriate applicant is chosen. The more effective the selection process, the more likely it is that the best possible candidate will be selected.

The selection process may involve:

- application forms
- interviews
- assessment centres, which may be used to assess the suitability of applicants for more senior positions
- written tests, such as mathematics or English
- computer interviewing, where an applicant uses his or her own computer to answer questions set by the firm's recruitment department
- handwriting assessment, such as assessment for clarity, spelling, punctuation, neatness or personality where writing skills may be an important part of the job
- personality tests and observations where the applicant is observed under varying conditions.

Selection A screening process in staff acquisition. The information gathered about job applicants is reviewed and the most appropriate applicant is chosen.

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Which procedure is used will depend on the costs involved, the time that can be taken, any legal obligations and the nature of the job to be filled.

Some of the procedures may be completed at the same time, using the internet or being conducted in person. Sometimes the selection process has several stages. In these instances, certain procedures will be used in the first round of interviews and then the same or different procedures will be used in the second round of interviews.

Communication skills and ability to work with other people as a team are seen as increasingly important. In this case, selection procedures may take the form of a group interview situation, in which the group is given a problem to solve. The individuals are assessed on their ability to interact with each other, to communicate ideas clearly and to contribute to finding a solution to the problem. Some businesses also use psychometric or aptitude testing as part of their selection process.

A selection process should reveal differences between candidates. It may be equally as important to eliminate the poorer candidates as the process continues. Some employment relations departments realise that good candidates may inadvertently be eliminated in the process (for example, if the candidate cannot spell very well and so does not perform well in the handwriting part of the selection process). Because of this, the department may try to evaluate the candidates on an overall basis.

Many skills required for a job may be improved through training. However, it is difficult to teach someone 'people' skills. Once the business has decided on the successful applicant, the chosen person is formally offered the position. The selection process must be completed fairly quickly, as a good applicant may have applied for several jobs and may have already been snapped up by the competition. After the offer has been made and before the applicant accepts the offer, there may be a process of negotiation over pay and entitlement issues. Often, the successful applicant will complete a trial period of several months and be paid on a casual basis before being accepted by the business as a permanent member of staff. As mentioned previously in this chapter, this is known as a probation period. The selection process is also applied to part-time, casual or contract workers.

Activity 15.2
Research

Further research the occupation you are interested in. Identify the courses or training that you would need to undertake to be qualified for this occupation. Also complete research on where you would need to go to gain these qualifications, how long the course would take to complete and the cost of the course.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 15.7 Applicants may be put through several stages in the selection process.

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15.3 Development

The staff of a business can be its most valuable asset and provide it with a competitive advantage over other businesses in the industry. In order to maintain this edge, the business ensures it continues to develop the skills and capabilities of its staff. Each business has a different way of operating; that is, it has an individual culture.

Development involves preparing employees for future responsibilities within the organisation due to a change in the business's strategies or a growth in its size or market share. Providing staff with a wider range of experiences in activities completed by the business results in greater flexibility and increased capacity for change to take place successfully. An example is a restaurant waiter also acting as a barista.

An **induction** or orientation procedure introduces the new employee to the business. It allows them to become familiar with the workings of the firm.

This may take a few days, during which the new employee learns about such matters as staff requirements, codes of conduct, rostering, grievance procedures, positions, work systems, techniques and computers. New employees should feel they know where they fit in and where the business is headed (that is, its goals). This enables them to be secure and comfortable in their position and allows them to better understand the culture of the business.

Training includes any activities aimed at improving an employee's present and future performance in the workforce. It results in upgrading skills, knowledge and competency levels in order to better meet the needs of the business.

All training should be regarded as non-threatening and offering new opportunities for skill development.

Training methods can include:

- on-the-job training – including advisers, traineeships, apprenticeships and job rotation
- off-the-job training – TAFE and university courses, in-services and seminars.

Trainees and apprentices need to be supervised while on the job. Work may proceed slowly while they are learning new skills. This practical component of the employee's training is backed up by the TAFE lectures and course material, which can often be far more theoretical in nature than the training the apprentice or trainee receives on the job. Traineeships and apprenticeships are successful systems used for plumbers, mechanics, electricians, chefs and other tradespeople. To increase employee expertise, businesses may organise lectures by guest speakers or their own specialists or arrange conferences. In some cases, testing can be used to maintain a high standard among employees or representatives of the firm.

Induction Introduces new employees to the business, allows them to become familiar with the workings of the firm and provides them with information about the firm's day-to-day operations.

Training Any activities that are aimed at improving an employee's present and future performance in the workforce.

Performance appraisal A formal assessment of how well a person is working – the person's strengths. It provides a basis for such matters as future training needs, pay rises, promotions and possible further development.

Source 15.8 A waiter acting as a barista is an example of development.

Training and development of staff requires evaluation of training activities in order to measure their effect on staff performance. The success of training needs to be established to determine whether the program achieved its objectives.

Performance appraisals can also be carried out. This requires a formal assessment of how well

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Source 15.9 Staff training does not always have to be in the workplace.

a person is working and would provide a basis for such matters as future training needs, pay rises, promotions and possible further development. In all cases, the business must weigh up the costs of training and development undertaken by comparing it with the expected benefits provided to the business. When new technology is considered, training and development costs should be included in the evaluation. In many cases, some work time is lost when training takes place. Many occupations require ongoing training to keep up with developments in areas of technology, legal issues and health and safety of staff.

In most instances, training and development results in increased motivation of employees, greater business flexibility, and improved use of technology and innovation.

Business Bite

Many professional associations require their members to complete a certain number of hours of professional development each year. In the case of Chartered Accountants Australia and New Zealand, members must complete 40 hours of professional development annually.

Why Qantas

We never stop learning, working towards our career goals one experience at a time.

Training and development

So you can perform to the best of your abilities and grow your career, your development is a priority. On the job training and coaching is supported by formal training opportunities to keep you ahead of the curve.

The Qantas Group has a comprehensive talent pipeline program focussing on new graduate talent, emerging leaders and senior talent management. Our goal is to provide opportunities to our employees wherever possible.

Source: https://www.qantas.com/au/en/about-us/qantas-careers/why-work-for-qantas.html.

Digital quiz
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15.4 Maintenance

Maintenance covers both the maintenance of a business's databases and the maintenance of its most valuable asset, its staff.

Maintenance of databases

A **database** is used to maintain the records of a business, including its employee information. A skills inventory is a database that contains information on the skills, expertise and qualifications of the current staff. The advantage of this register is that it enables a business to search for specific information when needed (for example, current staff with training in a specific skill to fill a particular position). This database could include personal information, such as marital status, medical history, skills and training that the employee has undertaken, and home address and hobbies. This information may only be accessible by specific staff because of privacy issues. Therefore, a security system (such as passwords) would need to be in place for database access.

Maintenance of human resource staff

Firms invest considerable amounts of time and money into recruiting and selecting an appropriate new staff member to fill a vacant position. They also incur the expense of induction of new staff and training in order to develop the skills of new and existing staff. All these steps are undertaken with the purpose of operating the business more efficiently and moving towards achievement of its goals. The firm needs to make sure it can keep the employees who are valuable to the development of the business. It does this through **maintenance** – that is, by providing the working conditions and work environment that motivate staff to be increasingly productive, gain satisfaction from their work and remain loyal to the firm. If the firm retains loyal and committed workers, a business will be able to:

- increase its productivity
- improve the level of morale among workers
- improve communication between management and workers
- reduce the level of absenteeism
- decrease costs through lower **staff turnover**.

A high level of staff turnover often indicates that worker morale is low and that employees may be dissatisfied with their job. A major cause of dissatisfaction may be low monetary benefits.

Monetary benefits

In Australia, minimum wage rates and minimum working conditions are set out in an award. These awards are based on specific occupational groups. Many workers have also entered into workplace contracts. These are known as agreements.

The award for various occupations is influenced by specific factors, such as age, educational qualifications, job location, risk/danger involved and days/hours of work. Some firms provide over-award payments in order to gain benefits from their staff. Workers may feel greater motivation and be rewarded for improved productivity.

Wages received are based on hourly rates of pay and may include overtime payments for work outside normal hours. **Salaries** involve an annual rate of pay, divided into equal pay periods. Both groups of workers (wage earners and salary earners) have tax deducted from their earnings each pay period by their employer and sent to the federal government through the Australian Taxation Office (ATO). Professional people on a salary are often expected to continue working extra hours, if necessary, until the task is completed. This would occur, for example, in a firm's accounting department at the end of the financial year when it is essential to present profit figures to the ATO.

In some occupations, monetary benefits may be paid:

- according to sales – for instance, a real estate agent will receive a commission, which is a payment, based on the value of the sale, for the agent's services in selling the property
- based on an individual's output – payment of piece rates for fruit picking is an example, where fruitpickers are paid according to the number of crates of fruit they have picked

Database A large amount of information stored on a computer and used to maintain the records of a business.

Maintenance Providing the working conditions and work environment that motivate staff to be increasingly productive, gain satisfaction from their work and remain loyal to the firm.

Staff turnover The rate at which employees leave a business.

Wage An hourly rate of pay. It may include overtime payments for work outside normal hours.

Salary An annual rate of pay, divided into equal pay periods.

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Source 15.10 Intrinsic rewards can include the satisfaction and pride of a job well done.

- as bonuses – these are paid as recognition of an employee achieving their workplace targets
- through a shared ownership scheme – this may take the place of pay increases and provides the added incentive of workers 'owning' part of the business. Both Coca-Cola and Qantas have excellent employee share plan initiatives
- as fringe benefits – examples are a company car, a housing loan at a low interest rate, a mobile phone, an expense account, discounted purchases from the business and additional superannuation payments.

Non-monetary benefits Include greater job variety, more flexible working hours, increased status in the workplace or community, and intrinsic rewards.

Intrinsic reward A reward that comes from within the person. In the case of employment, it could be the feeling of satisfaction that comes with doing a job well.

Non-monetary benefits are often combined with monetary benefits to complete a remuneration package. This package represents payment to employees in exchange for their labour services. Non-monetary benefits may include greater job variety, more flexible working hours, increased status in the job, employees being allowed to manage themselves, or access to an employee-subsidised cafeteria. Additionally, there are **intrinsic rewards**, which are those that come from within employees themselves. This type of reward includes the satisfaction of a job well done, or a good inner feeling about the work people are involved in (for example, working for a charity or as a medical researcher). Remuneration packages are the total pay or reward to workers and managers for their labour services and may include both monetary and non-monetary benefits.

Non-monetary benefits are designed to provide motivation to individual workers so that they make a 100 per cent effort in their role in the business. People who receive satisfaction from their work often feel that their job is enjoyable and seems to take less effort, unlike those who are dissatisfied, and find that time at work passes quickly. Rewards often provide the incentive that encourages the extra effort and the feeling that the job is worthwhile.

In Australia, employees have gained many non-monetary benefits with the help of the union movement. Some of the benefits achieved are incorporated into the award system. Many people also negotiate special conditions in their own individual contracts with their employer. Some of the common benefits are as follows:

- Employees are entitled to a period of annual leave. In Australia, this is usually four weeks' leave with full pay after working one year in the same job.
- Australian workers on awards are entitled to 17.5 per cent loading on their annual leave. (Many wage agreements are moving away from this entitlement.)
- Additionally, after working full-time for the same firm for a continuous period of 10 years many people are entitled to long service leave, which is at least eight weeks' paid leave.
- Employees are entitled to have a percentage of their annual wage or salary paid into a superannuation account by their employer. This amount (the superannuation guarantee) is set to increase gradually: in July 2021 it was 10 per cent, but by 2025 it will be 12 per cent. Superannuation is a form of fixed savings for employees' retirement.

For a firm, the cost of employing staff is not simply the wage or salary that they are paid. There are on-costs, which also need to be taken into account. These additional costs include workers compensation insurance, sick leave, fringe benefits, superannuation and possibly payroll tax to the state government. Many of these are legal requirements.

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Business Bite

Forbes magazine has compiled a series of six effective strategies that its team believes employers should use to motivate employees in the workplace.

1. Set goals to create meaning

Goal-setting gives employees meaning in their day-to-day roles.

2. Celebrate milestones big and small

They can be social or cultural, or they can focus on personal development.

3. Provide meaningful feedback

Consider the golden ratio of 5:1 – if you deliver five positive takeaways to one negative piece of feedback, people won't feel overwhelmed with criticism. The goal should be to help your people grow and develop, so providing ongoing, timely feedback is crucial.

Source 15.11 Providing meaningful feedback is an effective strategy to motivate employees.

4. Empower problem solving and learning

It's important to let employees lead with their own ideas and solutions. That way, they'll know their skills and perspectives are valued.

5. Follow through on promises

Keep employees motivated by establishing an atmosphere of trust and consistency that's sustained from the top down. Be mindful of the promises you make: these can have a direct impact on employee engagement because as a manager, you represent the organisation.

6. Experiment and learn

Maintaining motivation in your people is an ongoing task filled with opportunities to experiment and learn what works (and what doesn't work) for your team.

Source: *Forbes*, https://www.forbes.com/sites/rebeccaskilbeck/2019/02/12/six-strategies-to-maintain-employee-motivation/#40a69bd01d35.

Activity 15.3
Analysis

'Employees are motivated more by money than by working conditions.' Construct a table that suggests three arguments supporting this statement and three arguments against this statement.

Digital quiz
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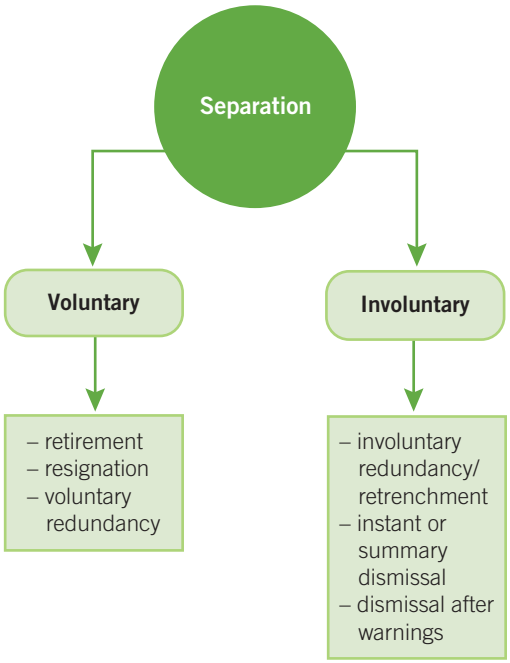
15.5 Separation

Separation involves the ending of the employment relationship. This separation may come from either the employee or the employer. It is the termination of the employment contract between the employee and the employer.

In many cases, the staff of a particular firm may provide the business with a competitive advantage over other businesses in the same industry. It is very important that an employer is able to acquire and develop the right staff for the business and can maintain them by providing adequate incentives to keep them motivated, productive and satisfied with their work. In addition, a business needs to have ways to remove staff who do not contribute at a high enough level to be a valued human asset for the business. Separation may be on a voluntary basis, when the employee wishes to leave of their own free will. It may also be involuntary, when an individual member of staff is asked to leave.

Separation The ending of an employment contract. Separation may come from either the employee or the employer.

Source 15.12 Separation can be voluntary or involuntary.



Merger The joining together of two businesses to form one business.

Takeover One business buying a controlling interest in another business, such as by becoming a majority shareholder.

Voluntary separation

Voluntary separation may take the form of retirement, resignation or voluntary redundancy.

Retirement

When an employee retires, the employee has decided to give up full-time or part-time work. In Australia, since new legislation was passed in the 1990s, there is no 'official' retirement age. In the past it was 65 years of age for males and 60 for females. People may retire due to ill health; some simply lack the motivation to continue working and some plan leisure activities, such as travelling. Several firms provide counselling for people who intend to retire to help them plan their lifestyle changes. Australia has a 'greying' population; that is, older people make up an increasing proportion of the population. This factor combined with increasing life expectancy has meant that many capable and still productive people are available to businesses as a resource. Many of these older people have a great deal of experience and expertise in their field of work. It is recognised that the loss of this valuable resource is a disadvantage for many firms. A number of retired workers are now consultants and, in some cases, act as tour guides for groups of visitors to the business where they used to work.

Resignation

Some employees resign; that is, they leave their jobs for reasons such as a need for change in their lives, dissatisfaction with their role or because they need to move interstate. In this case, the employee needs to give the employer notice of their intention to leave the job. The length of notice required depends on the industry involved and the employee's contract. In many occupations, on average, employees are required to give four weeks' notice.

Voluntary redundancy

Employees can nominate themselves for voluntary redundancy when their existing job is no longer required by the firm, possibly due to changes in technology, a **merger** or a **takeover**. These individuals may have been offered a redundancy package and find it in their financial interest to leave the job earlier than they had initially planned.

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Involuntary separation

Some employees may be required to leave their place of employment through the decision of management. This is known as **involuntary separation**. In this case, management decides which employees will no longer be required. This can occur when the skills of specific employees no longer suit the needs of the business.

Involuntary separation may take the form of involuntary redundancy or dismissal.

Source 15.13 In the case of resignation, employees are required to give notice.

Involuntary redundancy

A firm that has undertaken a merger or takeover may now have a duplication of tasks, resulting in redundancy of unnecessary staff. Redundancy is the termination of employment due to the firm closing down or the job no longer being required due to rationalisation, restructuring or new technology. In the last case, the actual skill of the worker is outdated and no longer used in the industry. For example, in Australian supermarkets checkout staff are being replaced with self-serve machines. In order to terminate employment in this way, the employer would need to make redundancy payments to employees based on seniority and years of service to the firm. The *Employment Protection Act 1982* (NSW) provides a minimum scale for severance payments for all permanent employees who work under New South Wales awards for an employer who has over 15 employees. Employers with fewer than 15 employees are exempt from these provisions. However, relevant state awards or agreements can provide entitlements over those provided for in the Act. More information can be found on the NSW Industrial Relations website.

Involuntary separation Occurs when the employer terminates the employment contract. This may include involuntary redundancy or dismissal.

Deregulation The government's removal or reduction in controls and regulations on an industry or sector of the economy or market in order to achieve greater competition.

If a business downsizes due to a fall in demand for its product or service, it may need to retrench staff. Retrenchment involves cutting back or reducing the number of staff. Some of these employees may be offered their jobs back if demand increases. In the 1980s and 1990s, the banking sector undertook significant retrenchment programs due to increased competition, **deregulation**, mergers and major changes in technology.

Video 15.1 Redundancy

The remaining employees are often left feeling insecure about their jobs, and productivity may drop as a direct result of this. Their view of the retrenchments may differ from the view of the employer. Remaining employees may believe the employer has retrenched loyal staff due to cost-cutting and greed on the part of the business. Because of this, many firms provide counselling or try to find retrenched workers jobs with other businesses.

Source 15.14 Being made redundant or retrenched from a job can be a stressful situation, but many businesses offer counselling or assistance with finding new employment for affected staff.

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Business Bite

In 2020, Network Ten announced mass redundancies across its programs. Well-known television presenters and staff employed behind the scenes were told that their services were no longer required. The reason for this was a significant fall in advertising revenue. These redundancies could allow the network to save considerable amounts of money in wages and salaries.

Dismissal

Dismissal occurs when the employer terminates an employee's employment contract due to the unacceptable conduct or behaviour of the employee. It can take the form of:

- instant or summary dismissal
- dismissal after a series of warnings.

Instant or summary dismissal is the immediate termination of the employee's contract without notice. This would happen in instances of theft from the firm, gross negligence (extremely careless behaviour), absenteeism, drunkenness or misconduct by an employee. Dismissal after a series of warnings may follow incidents such as continual lateness or failing to perform the duties as required. In the latter case, the employee may be issued with a written warning and provided with counselling or assistance to improve his or her behaviour. After three warnings, the employer may dismiss the employee. The government has passed unfair dismissal legislation to protect employees from 'harsh, unjust and unreasonable' dismissals, such as in the case of discrimination. The employee can appeal the employer's decision to an industrial relations tribunal, such as the Fair Work Commission. In many cases, the employee is given the option to leave the business before being sacked.

Businesses should have a written policy setting out the procedures that managers should follow in cases requiring discipline, dismissal or retrenchment of staff.

Digital quiz
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Source 15.15 Dismissal may occur after a series of warnings.

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Chapter summary

The processes involved in the human resource cycle, which includes the function of employment relations, are acquisition, development, maintenance and separation of the firm's workforce.

For acquisition, the business needs to be able to identify staff needs, recruit suitable applicants with the expertise and appropriate skills to complete the job, and then select the best possible candidate.

The development of staff includes all forms of training that aim to improve the employees' present and future performance in the workplace.

Training results in upgrading of skills, knowledge and competency levels in order to better meet the needs of the business.

Maintenance of staff is achieved through monetary and non-monetary benefits, and achieves loyalty, job satisfaction and improved work relations.

Separation may be voluntary, as in a worker's retirement or resignation, or involuntary, through dismissal or redundancy/retrenchment.

The employment contract includes employees' and employers' rights and responsibilities and is enforceable by law. Relevant laws include the *Workplace Relations Act 1996* (Cth), the anti-discrimination Acts of the New South Wales and Commonwealth governments, affirmative action Acts and occupational health and safety Acts.

End-of-chapter tasks

Chapter revision task

Rewrite the following sentences using your own knowledge and some assistance from the first letter provided to fill in the spaces.

- Employment relations deals with the relationship between e_____ and e_____.
- The human resource cycle begins with a_____, followed by d_____ and m_____ and ends with s_____ from the business.
- During acquisition, staffing needs are i_____, then r_____ and s_____ take place.
- New employees are offered a r_____ package.
- The main idea behind recruiting is to accumulate a p_____ of potential candidates for the job.
- A d_____ is used to maintain the records of the business.
- Monetary and non-monetary benefits are included in the m_____ of a worker and also motivate workers.
- Monetary benefits include w_____ and s_____.
- Rewards of an i_____ nature come from within the employees themselves.
- The ending of the employment contract is called s_____ and may be voluntary (such as in r_____) or involuntary (as in s_____ d_____).
- Employers' responsibilities to their employees include a d_____ o_____ c_____ and to provide w_____ and pay the appropriate w_____.

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- Discrimination is the u_____ treatment of a person, racial group or minority group and is based on p_____.

Multiple-choice questions

1 In a business, the employment relations function deals with the relationship between which of the following?

A Consumers and employers
B Employers and employees
C Employees and staff
D Staff and consumers

2 Which stage of the human resource cycle is superannuation classified as?

A Recruitment
B Development
C Maintenance
D Separation

3 Matthew is recruited externally. Which of the following processes is an advantage to a business in this situation?

A To accumulate a pool of potential candidates for a job
B To select the most appropriate candidate
C To advertise a job vacancy
D To identify a vacant position

4 Which of the following is a reason why managers may resist the implementation of training programs within a business?

A Training wastes employees' valuable time.
B Training could involve additional costs to the business.
C Training allows staff to become more skilled and then leave the business.
D Training provides the business with a greater competitive advantage.

5 A firm contacts an employment agency and provides it with details of a job description. Which employment relations task will the agency be completing on behalf of this business?

A Time management
B Selection
C Recruitment
D Development

6 What are the minimum standards of employment for all members of the Australian workforce known as?

A Award
B Enterprise agreement
C Better off overall test
D National Employment Standards

7 Samir rewards his staff by offering incentives that involve awards, prizes and gifts. Which of the following reward systems is Samir using?

A Monetary rewards
B Non-monetary rewards
C Extrinsic rewards
D Intrinsic rewards

8 Which government organisation is responsible for all matters related to the negotiation and enforcement of wage agreements?

A Industrial Relations Commission
B Workplace Australia
C Fair Work Commission
D Employment Commission

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9 What does the superannuation guarantee rate mean?

A An employee is entitled to this percentage of his or her annual wage to be placed into a superannuation account.
B Superannuation is guaranteed to make this rate of interest.
C It is the level of superannuation a person needs to have to retire.
D It is the rate of savings an employee needs to have.

10 What does the term 'separation' involve for a business?

A Multiskilling
B Division of labour between departments
C Division of labour between a worker and management
D The ending of the employment contract

Short-answer questions

1 Identify and explain each stage of the human resource cycle.

2 A With the use of examples, distinguish between a right and a responsibility within the employment relationship.

B Outline the rights and responsibilities of both the employee and the employer.

Extended-response question

Explain the role played by the employment relations function in the success of a business. Describe the stages of the human resource cycle. Outline the rights and responsibilities that should be taken into account.

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16 Strategies in human resource management

Chapter objectives

In this chapter, students will:

- investigate a variety of human resource management strategies
- analyse different leadership styles and recruitment modes
- evaluate the impact of training and development, performance management and rewards
- explain the processes of workplace dispute resolution.

Key terms

- collective bargaining
- formal training
- grievance
- grievance procedures
- informal training
- job rotation
- mediation
- monetary rewards

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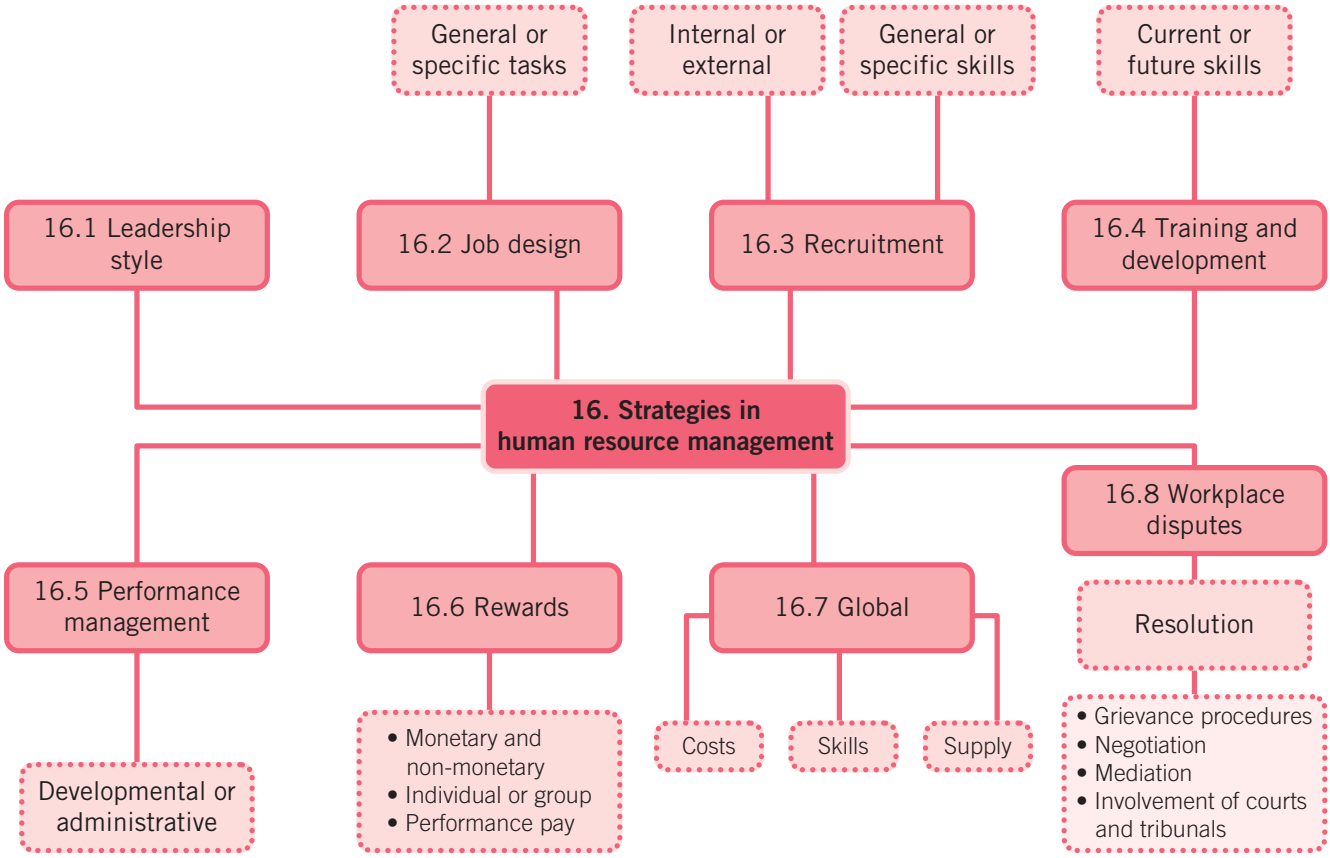
16.0 Introduction



Source 16.1 Strategies in human resource management

It is widely acknowledged that an important aspect of any successful business is the role of employees. Management is increasingly recognising the value of an effective human resource structure within a business. Businesses are seeking strategies to better manage employees across all aspects of the human resource cycle. This process of managing is broad and relates to many areas of the relationship between the business and its staff. It involves the manner in which employees are encouraged to participate in the decision-making process to more complex issues such as dispute resolution. The skill development of staff must also be considered, while management must examine strategies that effectively reward staff and recognise individual and team achievement. All these considerations are complex. Management should, however, seek to develop strategies that encourage and promote an effective and rewarding relationship between staff and the business.

16.1 Leadership style

Leaders form a fundamental role in human resource management. They make decisions, develop strategies for the development of the business and interact with employees. It is this process of interaction that is a key strategy in human resource management.

Increasingly, businesses are recognising the value of employees to their organisation. The employee and not the product is regarded as the competitive advantage. Hence, it is crucial for a leader to provide direction, implement plans and motivate staff in a manner that enhances employee workplace performance.

Leadership style is the manner and approach in which leaders of a business interact with staff. This interaction is based on:

- providing staff with directions and instructions
- implementing plans and organising staff
- motivating staff in a manner that promotes effective workplace performance.

Digital quiz
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It is crucial that the manner and approach leaders adopt towards employees inspire a positive culture within the business.

Types of leadership styles

Business theorist Kurt Lewin identified three different styles of leadership (see Source 16.2). Each form of leadership offers managers alternative approaches to the process of interacting with staff.

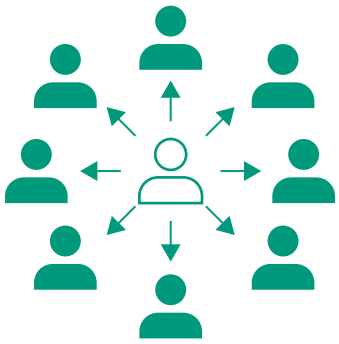
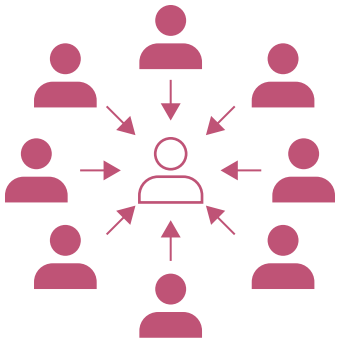
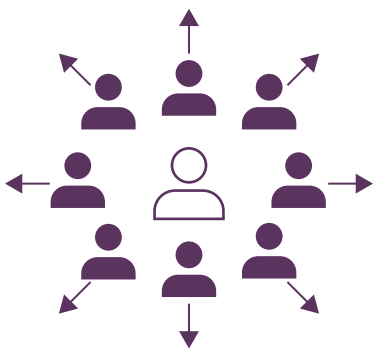
Authoritarian leadership

This style of leadership is also known as autocratic leadership. Under this style of leadership, a manager leads on the basis that they are responsible for telling their employees what they want done and how to accomplish the task. There is no role for employees to contribute to the process of making decisions. This is the responsibility of managers or leaders within the organisation.

Participative leadership

This style of leadership is also known as democratic leadership. The concept of inclusion is a fundamental aspect of this style of leadership. Participative leadership involves the leader including one or more employees in the decision-making process. Employees are consulted about what to do and how to do it. Given the involvement of staff in the decision-making process, the final decision-making authority still rests with the leader.

Source 16.2 Three leadership styles

Authoritarian		An authoritarian leadership style is used when an employee needs supervision. **When is it used?** • When decisions must be made quickly. • When management has resolved the issue and has the information to solve the problem. • With employees who are learning a new job and requiring supervision and instruction.
Participative		A participative workplace is one in which the manager encourages employee empowerment. **When is it used?** • When managers recognise that employees may have different yet effective ideas. • When the knowledge and skill base of staff are valued as part of the culture within the organisation. • When managers are seeking to motivate staff and encourage a form of ownership over their work. • To encourage employees to become empowered.
Delegative		Delegative leadership assumes that employees are able to represent the business and make decisions with a measure of independence. **When is it used?** • When employees have the relevant knowledge and skills to make the decisions. • When managers trust the ability of employees to make the right decisions. • When managers are seeking to motivate staff and encourage a form of ownership over their work.

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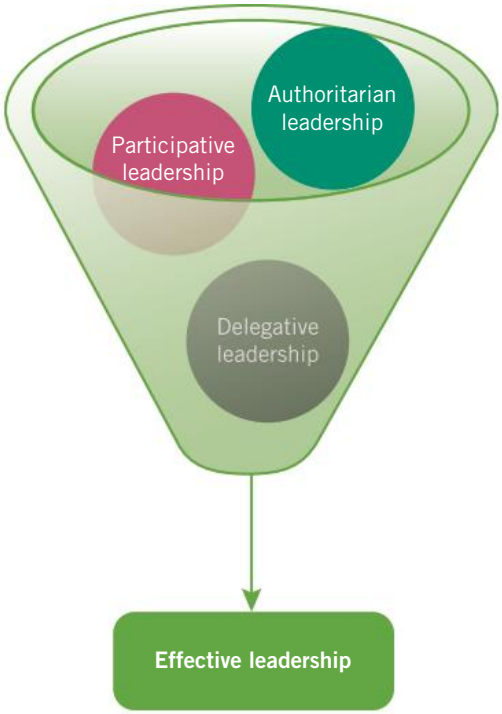
Delegative leadership

This style of leadership is also known as free-rein leadership. The leader allows the employees to make decisions. However, not all decisions then become the responsibility of employees. The process of effective delegative leadership involves a clear understanding between leaders and employees about who can make what decisions.

Choosing a leadership style

An effective leader makes use of all three leadership styles. The most appropriate choice of style is dependent upon the knowledge and skills of staff, the extent of the decision being made, the time available and the existing personal relationship between the leader and the staff.



Source 16.3 Effective leaders match their leadership style to the situation.

Review 16.1

Analysis

For each of the following scenarios, recommend and justify an appropriate leadership style.

1. Lisa leads a group of seven employees and relies on their knowledge and expertise to provide a service to the business's customers.
2. Matthew manages a small business that is experiencing considerable change due to a number of external influences.
3. Bei Jing leads a team of responsible and able employees who are aware of what areas of the business they can make decisions about. Bei is responsible for the final decision.

16.2 Job design

Job design is that function of human resource management whereby managers develop and specify the work activities of individuals or groups in the business environment. It involves the process of determining the types of tasks an employee will complete within the workforce.

Job design is a key strategy of human resource management. Its objectives are to meet the needs of the business and the employee. When designing the nature of the task itself, management must consider the needs of the business. The task must be developed in a manner that will allow the employee to work to achieve the organisation's goals.

Job satisfaction and enrichment are two key concepts that extend from the process of job design. Job satisfaction refers to the extent to which employees are satisfied working in their current position within the business, while job enrichment seeks to make use of employees' talents and abilities in the workplace.

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Source 16.4 Retail assistants will often have general tasks that do not require specific skills.

Human resource managers should seek to develop a job design that satisfies the employee's personal and workplace requirements. Job enrichment allows a business to develop tasks with the abilities of existing staff in mind. The task may also challenge the employee through increased problem-solving situations, thereby enhancing their skill development. Job enrichment reduces the boredom associated with many types of work. Effective job design often leads to increased productivity and efficiency within the workforce through increased job satisfaction. This can also be achieved through **job rotation.**

Job rotation A system in which an employee is moved through a variety of tasks so as to increase their individual skill development and minimise boredom associated with repetitive tasks.

General or specific tasks

Part of the job design process is to define the way work will be performed and the tasks that a given job requires. To design jobs effectively, one must conduct a job analysis in the context of the larger work unit's work flow process.

It may seem that the most efficient way to conduct the overall work flow is to break it down into specific tasks, and have each task, or small group of tasks, performed by separate employees trained to administer these tasks. This was the basis of early job design theory, particularly applied to manufacturing. A production line is a classic example of this – every person on the line does a specific, repetitive task, and the final product is of high quality because each individual is expert at their specific task. Another example might be a hairdressing salon, where for a single customer getting their hair coloured, one person might mix the colour, another apply it, a third shampoo the hair and a fourth blow-dry it at the end. The salon staff doing these tasks have different skill sets and levels of experience.

Source 16.5 What must be decided during the job design process?

Who does the job?	The business examines the characteristics of its workforce. The emotional and physical characteristics of the workforce must be considered, along with the skills and qualifications of employees.
What needs to be done?	Managers determine the task that needs to be completed. This is generally a broad concept, without specifying individual procedures involved in the task.
Where must the task be completed?	Managers must consider the physical elements of the business and consider the most appropriate area for the employee to complete their tasks.
When must the task be completed?	Depending on the nature of the task, employees are often working to deadlines. Managers must consider appropriate lead-in times to provide employees with sufficient time to complete the task.
How must the task be completed?	Managers must determine the individual processes involved in completing the task. This involves breaking down the task into more simplified stages. Employee input into this process is often regarded as a valuable source of job satisfaction.

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However, this does mean that employees may be performing the same repetitive tasks all day. An alternative approach is to design jobs around general tasks – having the employee complete a related group of specific tasks, or even the whole end-to-end process. This may lead to greater employee satisfaction, as it means that they can see the 'big picture', there is more variety in the work day, and they have some autonomy on how and when the individual tasks are completed.

Nevertheless, if a high degree of specialised skill is required, it may be appropriate to design a job around specific tasks.

Activity 16.1
Construction

Using the five key considerations in the job design process, create a job design for a fast-food store that is due to be opened. In your response you should focus on the role of employees.

16.3 Recruitment

Recruitment is a fundamental aspect of human resource management. It is the strategy whereby management seeks to employ an individual for a vacancy that exists within the organisation.

Once the decision to recruit is made, an analysis of the job to be done must be completed. This is so that the selectors know what skill characteristics applicants must possess, what qualities and attitudes are desirable and what characteristics may be a disadvantage.

Internal or external

Recruitment may be completed internally or externally.

Internal recruitment occurs when the position is filled by existing employees within the business.

External recruitment occurs when the position is filled by an individual who has not yet worked for the business.

Some issues for the business to consider in the recruitment process:

- The need to replace staff must always be examined carefully. Management must consider if it is possible to spread the workload over existing employees. This has the benefit of up-skilling existing employees and making cost savings for the employer, as the former staff member is not replaced.
- Given the complexities involved in human resource management, businesses should consider if the use of specialised recruitment firms is more relevant to their needs. This may allow a greater degree of expertise to be used in the recruitment process.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Source 16.6 Benefits and disadvantages of internal recruitment

Benefits	Incentives for staff to improve their performance; promotions seen as a reward for effective work; the employee having an existing understanding of the culture of the business.
Disadvantages	Staff overlooked for the position may lose motivation; the business may be denying itself new ideas by recruiting internally.

Source 16.7 Benefits and disadvantages of external recruitment

Benefits	The business benefits by encouraging new ideas; the new employee is not aware of existing issues within the business.
Disadvantages	It may take time for the new employee to settle into the organisation; they may experience resentment from existing staff.

Activity 16.2
Comprehension

HabebStar Industries has recruited a new manager from an external organisation. As a human resource officer, prepare a report to the owners of the business justifying why external recruitment offers the business greater benefits than internal recruitment.

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General or specific skills

When recruiting someone to fill a vacancy, an employer's list of requirements will probably include both general and specific skills.

General skills are those that all individuals have and relate to their level of initiative, communication and problem-solving abilities. These skills can be easily transferred across occupations. However, not all general skills relate to all roles. For example, a receptionist might require 'good communication skills' but not necessarily 'ability to manage competing deadlines'.

Specific skills relate to that occupation and often involve some degree of knowledge and training. They might include skills as varied as using particular software programs, speaking a second language or riding a unicycle.

Activity 16.3
Research

Choose a career path that you would like to follow from next year.

Identify the general skills that you would require for this position and list three specific skills related to this role.

Digital quiz
Please see the Interactive Textbook to access digital activities.

16.4 Training and development

Training and development are essential components of any successful business. It is important for a business to provide its employees with a means to improve their knowledge, skills and understanding of various activities related to the operations of the business. Effective training and development allow a business to successfully manage changes within its internal or external environment. An example of this would be operating new machinery.

Current or future skills

A business must assess if the skill sets of its staff are appropriate for its short-term and long-term goals. An effective human resource manager should determine the skills required by the business in the future and then engage in appropriate training programs to ensure the staff are well equipped.

Developing current skills will help an employee perform better in their present role. For example, a bank employee who assesses business loan applications might do a course on understanding balance sheets.

Source 16.8 A mentor training a younger employee

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Development of future skills is not for the employee's current role, but for a role they aspire to. Development of skills for the future is an important part of the performance management process. Many large organisations have a leadership development program, where employees who are identified as potential future leaders within the organisation are given training to help them develop leadership skills.

Formal and informal training

Training may take place through formal or informal means.

Formal training involves employees taking on a role similar to that of students within the organisation. They are shown how to apply themselves to the new operations of the business and are later assessed on their level of understanding. Examples include lectures, seminars, trainee and apprentice schemes, and external courses.

Informal training occurs when the employee is shown or modelled the correct skills. It could simply be done by using a coach or mentor, or by the employee learning the work on the job. Training and development also provide employees with an opportunity to acquire the skills and experience they will need if they are to be promoted within the organisation or secure a position with another employer.

Induction

Induction is the process of providing new employees with the knowledge and skills necessary to ensure they are familiar with the organisation and day-to-day operations of the business. Essentially, it is a training program for new employees of an organisation or employees new to a position within the firm to quickly improve their productivity. It is also a common form of training within a business. Most induction programs provide employees with some history of the organisation and an overview of company policies (including policies concerning equal employment opportunity and work health and safety), work rules, codes of conduct and the employer's expectations. Employees are notified of leave arrangements, their starting and finishing times, appropriate dress codes and matters relating to union membership and grievance handling procedures. New employees may be assigned mentors, who are established employees within the business who act as guides or points of reference for the new employee.

Formal training Where an employee takes on a role similar to that of a student within the organisation, is shown how to work with the new operations of the business, and is later assessed on their level of understanding.

Informal training Where an employee is shown or modelled the correct skills through the use of a coach or mentor, or by learning the work on the job.

Business Bite

Source 16.9 McDonald's staff are given the opportunity to train to management level if they so wish.

McDonald's Australia is one of Australia's invested businesses in the training and development of its staff. Each year, McDonald's spends more than $40 million offering training programs to all employees, ranging from staff working in the store to all levels of management.

McDonald's Australia's website states:

We love nothing more than watching our employees grow.

Continued →

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Did you know that a lot of our most successful Managers started their careers as Crew Members? You can do it too, and the best part is you get to earn while you learn! If you've got the appetite to succeed, we have the opportunity. At Macca's, we believe in nurturing growth and development at all levels. We offer comprehensive training and development programs that make it easy to be successful.

A key McDonald's training program is the Pathway to Leaders initiative, which invests in staff interested in developing skills in management.

Source: McDonald's Australia.

Review 16.2

Analysis

Identify whether each of the benefits described below is provided by training and development or by induction:

1 improves employees' skills
2 encourages an improved awareness of the organisation's practices
3 provides the business with the human skills to move into new markets
4 helps employees to seek promotional opportunities with their current employer or a different organisation
5 makes employees aware of dispute resolution procedures
6 provides new employees with mentoring from other employees in the organisation
7 allows the business to constantly improve its operations.

16.5 Performance management

Performance management refers to the process of recognising the efforts and contributions of employees to their work. It involves an ongoing process of communication between a supervisor and an employee based on achieving the objectives of the business and the goals of the employee. The communication process would include the following aspects:

- clarifying expectations
- setting employee workplace objectives
- providing feedback
- evaluating employee performance.

Developmental or administrative

Performance management has both developmental and administrative benefits.

From an employee development point of view:

- the employee has an improved understanding of how their role contributes to the success of the business
- the employee has a clear understanding of what needs to be done to be successful in the job
- the employer is able to identify any problems early, and assist the employee with improving their performance
- performance review and improvement is ongoing and allows the employee to be continually aware of their own personal goals and those of the business.

Performance management can also support administrative functions:

- human resource managers can refer to performance evaluations when making decisions about promotions, transfers and employee rewards
- performance management data can help assess how effective the organisation's training and development programs are – if performance evaluations improve after the employee has attended a development course, that suggests it has been effective
- the data can also indicate the strength of the current workforce, and indicate if more or different employees are needed
- performance management communications are documented; this can be important if the organisation decides to take action against an employee with continued poor performance.

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Performance management cycle

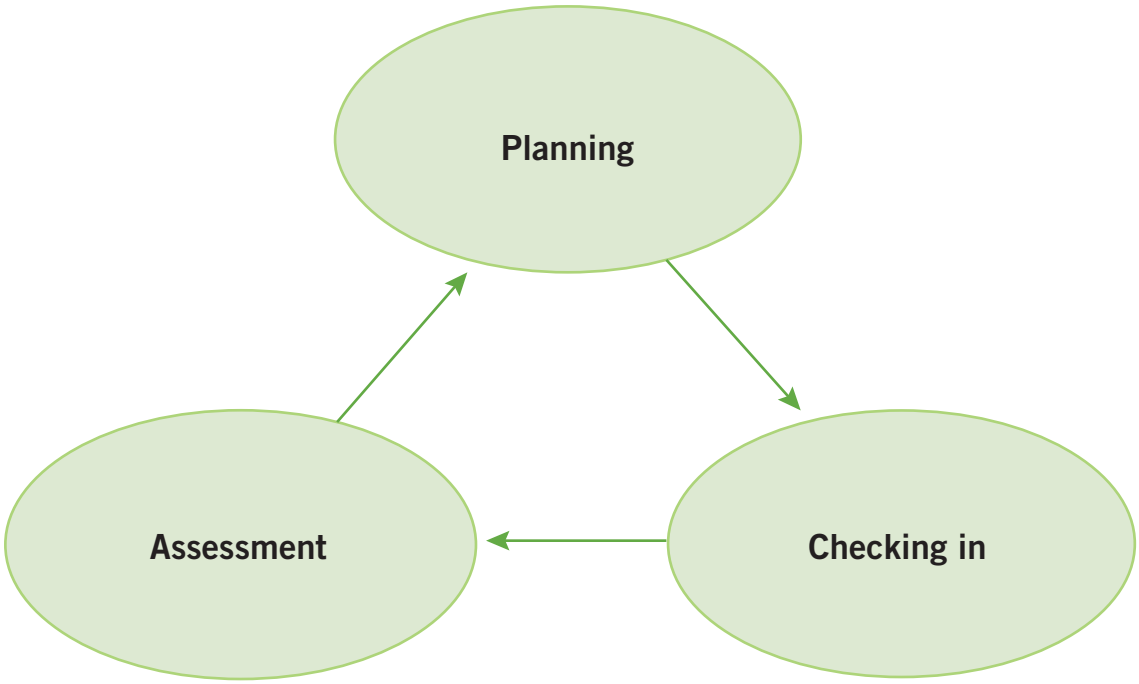
Reviewing performance and providing feedback to employees is not an isolated event. Performance management is an ongoing process that can be described as having three key stages:

1 planning
2 checking in
3 assessment.

Stage one: planning

This is the first stage of the performance management cycle and it is focused on goal-setting:

- expectations are developed between the employer and the employee regarding what tasks should be completed in the role and how those tasks should be completed
- goals are established between the employer and the employee. These goals must be realistic and achievable. The employee should also know that these goals can be exceeded. The goals may be expressed in terms of quantity, cost, quality or overall employee performance.



Source 16.10 The performance management cycle

Source 16.11 An employer should regularly observe an employee's performance to provide feedback.

Stage two: checking in

Once the performance objectives have been established, an employer should regularly observe an employee's performance to provide feedback. Management has a key responsibility to recognise and reward strong achievement and encourage improvement where needed:

- communication is developed between the management and employees
- employee motivation increases through recognition and rewards
- the employee is assisted to achieve performance objectives

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Stage three: assessment

Assessment is the final stage of the performance management cycle. It is the process of measuring the employee's performance against the objectives established in the planning stage:

- employee accomplishments, their view on the current position, possible areas of improvement, and suggested changes to the task are discussed
- results are examined against business and industry benchmarks
- possible reasons for the achievement or non-achievement of goals are discussed
- new goals are developed with changes to be implemented.

Monetary rewards Rewards given to employees that involve an additional monetary payment beyond their minimum legal entitlements.

Review 16.3

Comprehension

1. Outline how each stage of the performance management cycle allows a business to develop a competitive advantage in its management of human resources.
2. Briefly discuss why this structure is ongoing.

16.6 Rewards

An effective and efficient employment relations structure is one that incorporates a way of motivating all employees to work to the best of their ability and cooperate with one another to help the business achieve its goals. Many businesses use a combination of monetary and non-monetary means of rewarding their employees. It is important to note that some benefits employees receive from their employer are actually a part of their legal entitlements and should not be seen as rewards. These benefits include the 9.5 per cent superannuation contribution, and sick leave and annual leave provisions.

Monetary and non-monetary

Monetary

Monetary rewards are the most common types of rewards used in the workforce. They are additional payments that are given to employees and are beyond the employees' minimum legal entitlements.

Non-monetary

Not all employees are motivated to put greater effort into their work in return for increased monetary rewards. Businesses frequently offer non-monetary rewards, such as access to discounts, time out to work for charity, flexible working conditions and recognition programs such as 'employee of the month'. In addition, some employees are motivated by other benefits associated with the job itself or working for the company. Non-monetary rewards can be categorised as fringe benefits, status-related benefits and intrinsic rewards.

Individual or group

Across many businesses in Australia today, employees are placed by managers in work teams. These teams, or groups, share similar goals and job descriptions. Rewarding performance based on group achievement has a number of benefits:

- it encourages a greater sense of teamwork
- employees become more motivated as they are working not only for themselves, but also for others
- it improves communication between staff

Business Bite

Coles Supermarkets strongly believes in recognising the efforts and contributions its employees make to the success of the business.

The 'MyColes' program offers Coles employees rewards ranging from a 5 per cent discount in Coles-owned stores to paid parental leave and appreciation awards to staff who receive positive feedback from employees.

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Source 16.12 Group work can create a sense of teamwork in a workplace.

However, the process of rewarding performance based on group achievement may act as a detriment to the business as:

- not all employees may apply equal effort to the work process
- employees may have different personal goals that do not become recognised through team achievement
- conflict may occur within the group, restricting the ability of individual performing employees to be recognised.

Performance pay

Performance pay refers to the process of linking part of an employee's income to their performance at work. As the employee reaches targets and demonstrates improved performance, they are rewarded through increased pay, or bonuses. This concept of performance recognition reflects a belief that employee motivation is derived through increased financial benefits.

Benefits of performance pay are:

- monetary rewards are often a key motivator for employees. Performance may improve as employees are encouraged to work more effectively
- good employees are attracted to work for the organisation, as they may regard performance pay as a measure of their successful work attributes
- it encourages unmotivated and inefficient individuals to improve their performance

Disadvantages of performance pay are:

- there are many occupations in which the performance of the employee is considerably influenced by external factors, such as the attitudes of consumers, health and cultural concerns and general economic conditions, and consequently the performance of employees may be difficult to measure
- the possibility of conflict may emerge due to the process of measuring performance
- the concept of performance pay assumes that individuals are motivated by money, whereas some employees may simply seek non-monetary rewards as their form of recognition.

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Source 16.13 Difficult customers may affect performance pay.

16.7 Global

Cost, skills, supply

The environment in which Australian businesses compete is rapidly changing. More companies are entering international markets by exporting their products overseas, building production facilities in other countries and making use of foreign labour for technical expertise and cost savings.

Some businesses will want to employ labour that already has the skills it needs. Access to a cheaper workforce that possesses the required skills will be a key consideration for a business. A manufacturing business may want to hire low-paid scientists for new product development. A clothing company will need to hire a large number of workers who can operate sewing machines and work on a production line. An Australian business can redirect enquiry phone calls to a call centre in New Delhi, India, for example, where the calls will be answered in English by well-educated Indian employees who are paid less than their Australian equivalents.

A global business will have to balance the opportunity to reduce costs by accessing cheap labour against the cost of training labour with the skills required by the business. The ability of labour to learn new skills will depend on the country's education system. Some governments are investing a significant amount of money into education to create a highly skilled but still cheap workforce to attract foreign direct investment. Again, one such country is India, where university graduates are providing a valuable source of less-expensive employees for the IT and electronics industries.

16.8 Workplace disputes

It can be argued that, by their very nature, the interests of employers and employees conflict. Employers will seek to use the services of labour at the lowest possible cost, while employees will attempt to gain the best possible income and working conditions. Providing working conditions that meet the expectations of employees can often come at a high cost to a business. Other issues, such as rostering, leave entitlements, promotions and work health and safety, can also cause conflict in the workplace.

Dispute resolution processes

The process of resolving an industrial dispute can often be complex. It depends on the

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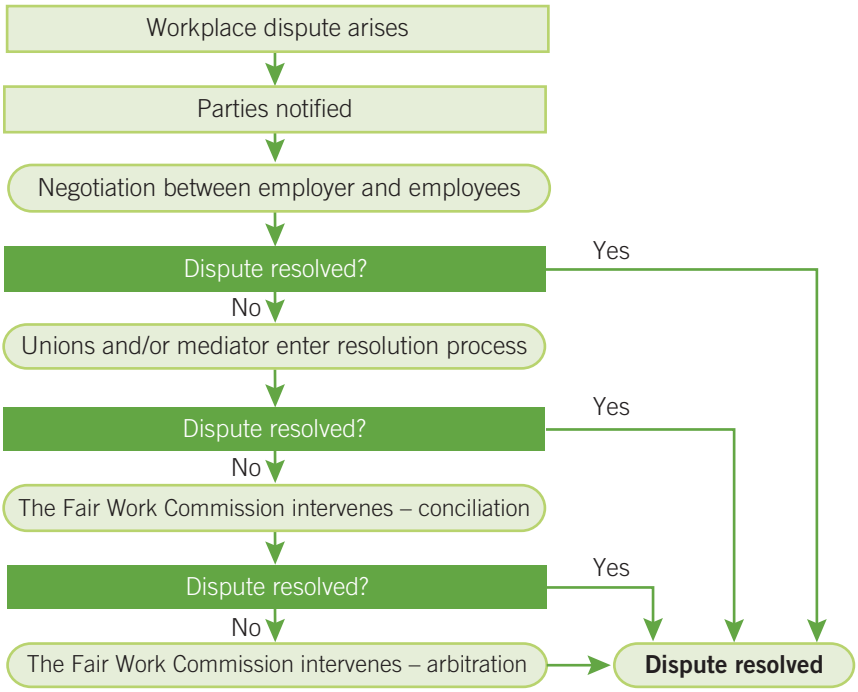

Source 16.14 The dispute resolution process

willingness of stakeholders to work together cooperatively towards a settlement where all parties are satisfied with the final outcome. When a dispute first emerges, all stakeholders must be notified. Employees may be informed that their work practices are either inappropriate or not consistent with the expectations of the business; or the employer will be informed that staff are concerned about operational issues within the business.

The culture and attitudes of management when responding to a dispute are crucial in determining the processes used to resolve it. Some managers may be hostile to employees, displaying an unwillingness and reluctance to acknowledge the concerns of their staff. Other managers will adopt a more behavioural approach, listening to staff concerns and providing some feedback as to possible solutions. The business that adopts the autocratic style is likely to encounter more problems in resolving the dispute and may not have direct control over the final outcomes, as the dispute may eventually be resolved by a government organisation whose decision is legally binding on all parties. The process of resolving an industrial dispute is outlined in the grievance procedure policy of the organisation.

Grievance procedures

A **grievance** is a dispute between parties. Many businesses have developed a grievance procedure policy, which outlines the process for resolving grievances in the workplace. It will specify the **grievance procedures**, which are the rules and procedures that employees, unions and employers must follow in order to resolve a dispute. Developing a grievance procedure policy for use in the employment relationship has many benefits. For instance, the policy:

Grievance A dispute between parties.

Grievance procedures The rules and procedures that employees, unions and employers must follow in order to resolve a dispute.

- provides a clear outline of the issues that are regarded as workplace grievances
- illustrates the correct and appropriate processes to use when raising a complaint
- provides a mechanism that can be used to achieve a quick resolution of disputes.

When a dispute emerges, some employees may feel the need to notify their trade union representative. Unions will inform employees of their legal rights and obligations in relation to the dispute. The union is also likely to offer assistance to employees in meeting with management to seek a resolution.

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Negotiation

The first stage in the process of dispute resolution is negotiation. Negotiation involves a discussion between both parties in an attempt to resolve the dispute. As discussed earlier, the attitudes of management in acknowledging the nature of the dispute and being prepared to listen to the concerns of employees are crucial at this stage in the resolution process.

Collective bargaining is the common term used to describe negotiations over workplace disputes within an organisation. Depending on the nature of the dispute and the ability of managers to deal with the particular grievance, an employer association may also be called on to assist the employer with negotiations. The matter may be complex and the business may lack the necessary skills and staff expertise to handle the dispute appropriately. It is likely that a small to medium business with a small, or possibly no, human resource department will seek assistance from its employer association. Larger businesses are often able to employ experts in industrial relations law to deal with disputes.

Collective bargaining The common term used to describe negotiations over workplace disputes within an organisation.

Mediation Occurs where an independent party with no ties to either stakeholder is asked to assist the conflicting stakeholders to reach a settlement.

Digital quiz
Please see the Interactive Textbook to access digital activities.

Mediation

As it is often the employer and the employee who are in dispute, they may find it confronting to work with each other in attempting to reach a settlement. In some cases, an independent party with no ties to either stakeholder may be requested to assist the conflicting stakeholders to reach a settlement. This party could suggest ideas or present issues in an alternative way. This process of resolution is known as **mediation**.

Video 16.1 Mediation

Source 16.15 Mediation may be required to resolve workplace conflict.

Involvement of courts and tribunals

Conciliation

Conciliation is an important part of the dispute resolution process. Should the parties to the dispute not be able to reach a settlement through negotiation or mediation, the Fair Work Commission will be notified and requested to assist with a resolution. The Fair Work Commission's role here is to assist stakeholders in reaching an agreement where all concerned parties are satisfied with the final outcome. It will adopt a very similar approach to mediation. However, the conciliator will be from the Fair Work Commission itself. When the Fair Work Commission requests that both parties attend conciliatory meetings, each party has a legal obligation to do so. While all parties must make every reasonable attempt to reach a settlement, the conditions of the agreement are not legally binding.

Arbitration

Arbitration is the final stage of the dispute resolution process. When a dispute reaches arbitration, it is clear that the parties have not been able to reach an agreement and that some degree of hostility still exists. During the process of arbitration, lawyers representing the disputing parties will present their case to the Fair Work Commission. This organisation will evaluate the arguments presented and reach a final decision. This decision is legally binding on all parties.

Source 16.16 Each party has a legal obligation to attend conciliatory meetings, when requested by the Fair Work Commission.

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Chapter summary

There are three styles of leadership within a business:
- authoritarian: managers lead on the basis of the view that they are responsible for telling their employees what they want done and how to accomplish the task
- participative: the leader includes one or more employees in the decision-making process
- delegative: the leader allows the employees to make decisions.

Job design is that function of human resource management whereby managers develop and specify the work activities of individuals or groups in the business environment.

Job satisfaction refers to the extent to which employees are satisfied working in their current position within the business.

Job enrichment seeks to make use of employees' talents and abilities in the workplace.

Job rotation is a system in which an employee is moved through a variety of tasks so as to increase their individual skill development and minimise boredom associated with repetitive tasks.

Recruitment is that strategy whereby management seeks to employ an individual for a vacancy that exists within the organisation.

Internal recruitment occurs when the position is filled by existing employees within the business.

External recruitment occurs when the position is filled by an individual who has not yet worked for the business.

Training develops employees' skills and knowledge. It can be formal or informal.

Induction is the process of providing new employees with the knowledge and skills necessary to ensure they are familiar with the organisation and day-to-day operations of the business.

Performance management involves an ongoing process of communication between a supervisor and an employee based on achieving the objectives of the business and the goals of the employee.

Performance management involves three key stages: planning, checking in and assessment.

Monetary rewards given to employees involve an additional payment beyond their minimum legal entitlements.

Some employees are motivated by other benefits associated with the job itself or working for the company. These are referred to as non-monetary rewards.

Rewarding performance based on group achievement has a number of benefits, including encouraging a greater sense of teamwork and improving employee motivation and communication between staff.

The process of rewarding performance based on group achievement may act as a detriment to the business, as not all employees may apply equal effort to the work process and individual members within the team may have different goals.

Performance pay refers to the process of linking part of an employee's income to their performance at work.

The location of skilled and unskilled labour will impact on a global business's decision about where to locate. It may wish to take advantage of cheap labour offered in developing countries.

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A grievance procedure policy outlines the process for resolving disputes that may occur within the employment relationship.

Negotiation involves a discussion between disputing parties in an attempt to resolve the dispute. It seeks to reach a settlement in which all parties are satisfied with the outcome.

Mediation involves the use of an independent third party seeking to assist the disputing stakeholders to reach a common settlement.

Conciliation occurs when the Fair Work Commission acts as a mediator in a dispute. In some cases, arbitration may be required. The outcome of arbitration is legally binding on all parties.

End-of-chapter tasks

Chapter revision task

Discuss the different processes of dispute resolution in the workplace. How can a leadership style contribute to the effective resolution of such disputes?

Multiple-choice questions

1 Which of the following is a benefit to a business if managers lead using a participative style?

A Employees may work more effectively as they are encouraged to take greater ownership of their work tasks.
B Employees are required to work with increased supervision due to the complexity of the task.
C Managers empower staff through clear lines of authority and decision-making channels.
D Managers become less inclusive of employees, thereby developing stricter codes of conduct within the business.

2 Which of the following describes the concept of job design?

A Staff are provided with an outline of how to complete their role.
B Staff are provided with an outline of the expectations of the business.
C A program through which management encourages productivity from employees.
D A program through which employees work with greater responsibility.

3 Theton is a leading distributor of home entertainment products across Australia. Management has appointed an existing employee for a newly created position within the organisation. Which of the following is a benefit of this form of recruitment?

A The employee may bring new ideas to the business.
B Existing employees may become resentful.
C The employee lacks knowledge regarding the culture of the organisation.
D Existing employees may become more motivated.

4 A business has decided to reduce the funds allocated to the training and development of its staff. What implication could this have for the operations function of the business?

A Staff will be more skilled in completing their roles.
B Staff may be become less motivated to sell the product to consumers.
C The business will experience an increase in expenses allocated to the human resource cost centre.
D The business could experience a decline in profitability as it loses its competitive advantage.

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5 An employee and their manager are discussing how well the employee is progressing in achieving their work goals. Which stage of the performance management cycle is being described here?

A Planning
B Checking in
C Assessment
D Goal-setting

6 Which of the following represents a disadvantage of performance-based rewards?

A Employees do not all share the same level of skills and expertise.
B Employees may work together to more effectively achieve the goals of the business.
C The performance of the employee may be difficult to measure.
D The performance of the employee allows the business to implement performance management reviews.

7 Why do businesses offer employees rewards?

A To recognise the value of their efforts in the operations of the business
B Because it is required by federal government legislation
C To provide employees with an income to achieve a satisfactory standard of living
D To minimise the possibility of industrial conflict

8 Which of the following issues is not a consideration for a business seeking to make use of foreign labour?

A The economic conditions of the new country
B Cultural factors impacting upon consumer trends
C The ability to train and use technology
D Language barriers

9 Along with the establishment of industrial tribunals, how else may governments influence the dispute resolution process?

A By forcing employees to comply with the request of employers
B By encouraging all stakeholders to reach a quick settlement
C By passing laws influencing the dispute settlement process
D By forcing parties to attend arbitration immediately upon a dispute arising

10 Which of the following is a reason why stakeholders may not seek arbitration in the resolution of a workplace grievance?

A The decision of the Fair Work Commission is legally binding.
B The decision of the Fair Work Commission ensures that the dispute is resolved.
C The decision of the Fair Work Commission allows both parties to determine a fair outcome.
D The decision of the Fair Work Commission is likely to result in a winner–loser outcome.

Short-answer questions

1 Create a diagram outlining the processes involved in the resolution of grievances in a workplace.

2 Explain how managers could use different styles of leadership to effectively manage their staff.

Extended-response question

Discuss the effectiveness of performance management in training and rewarding staff in a workplace.

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17 Effectiveness of human resource management

Chapter objectives

In this chapter, students will:

- identify, analyse and evaluate the indicators of effective human resource management.

Key terms

- absenteeism
- level of disputation
- worker satisfaction

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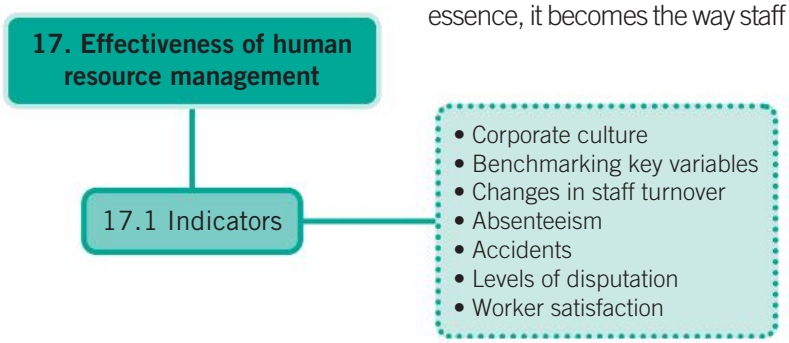
17.1 Indicators

An effective human resource management function is one where management and employees work well together in their efforts to achieve the goals of the business. The needs and interests of both employees and the business are also considered. The effectiveness of the employment relationship can be measured from a number of different perspectives.

Corporate culture

Corporate culture refers to the culture within an organisation. It relates to the unwritten rules, values and beliefs within a business and directly influences the relationship between management and employees. All successful businesses are able to translate their values and beliefs into actions. It relates to the way staff interact with each other, their dress code and approaches to teamwork, problem-solving and grievances. An effective corporate culture is one that is believed, demonstrated and acted upon by management and employees. In essence, it becomes the way staff perform their work.

Video 17.1 Key measures of effective human resource management



Source 17.1 Indicators of the effectiveness of the employment relationship

Business Bite

An article in the *Huffington Post* explored 10 key features of Google's corporate culture:

1. No 'real life' distractions for staff
2. Office design based on qualitative and quantitative data
3. All-staff meetings on Mondays
4. Supporting community volunteering
5. Workplace flexibility
6. Working away from the desk
7. Orientation for new staff
8. Dog-friendly workplace
9. Post-death benefits to family
10. Financial planning support.

Source 17.2 Creating a bright and colourful work environment is only the first step in Google's revolution of human resource policies.

You can read the full article via the link at https://cambridge.edu.au/redirect/9588.

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Corporate culture is generally determined by the actions of management towards employees. Today, many businesses encourage their employees to make decisions based on thinking as if they were the business owner. Teamwork is also encouraged as the basis of a strong corporate culture: ideally, team members will work well together, share values, and make decisions that are in line with the business's goals and objectives.

Benchmarking key variables

Benchmarking is the process of measuring an employee's performance against established standards. It is also known as the process of establishing key performance indicators (KPIs), which are goals the business sets for employees to achieve. The benchmark for a manufacturing firm, for example, may be set at 100 units of a good made per week by each employee, with zero defects. These standards are often set by businesses that are regarded as leaders in their industry. Benchmarking is a form of control in an organisation. If employees are unable to meet performance goals on a regular basis, it will be clear that management must examine why this is occurring. The reason may be a lack of motivation or that the staff are not adequately trained.

Changes in staff turnover

Staff turnover is the rate at which employees leave a business. As discussed in Chapter 15, some employees leave their employment voluntarily to seek employment opportunities elsewhere or to retire. Others, however, are forced to leave owing to their misconduct or the need for retrenchments. A high level of staff turnover caused by voluntary separation is indicative of poor employment relations within a business. Employees are expressing their dissatisfaction by leaving. This dissatisfaction could arise from the culture of the business, management styles, or the lack of acknowledgement and input that should be available to employees. High staff turnover is costly to a business. The departing staff member's entitlements need to be paid out, and there is also the expense of recruiting a replacement: job advertisements, the selection process and training the new staff member. Additional costs will also be incurred through such factors as the loss of the employee's experience and knowledge. Also, the business has invested time and money in training and development of employees' skills and knowledge, and faces the possibility of losing experienced and highly skilled staff to its competitors.

Source 17.3 In their 2018 *Turnover and Retention Research Report*, the Australian HR Institute stated that 37 per cent of employees in the 26-35 age bracket left their employers each year. Employers taking part in the survey indicated that an ideal turnover rate is less than 10 per cent.

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Absenteeism

Absenteeism refers to employees not attending work, usually for reasons such as illness or family responsibilities. In Australia, all full-time employees are entitled to a minimum of 10 days paid sick leave per year. While most employees take 'sick days' for medical or family reasons, others may use them to express their dissatisfaction with the workplace, though some workplaces require the employee to supply proof such as a doctor's certificate to be entitled for the paid sick leave. Absenteeism is costly, as it means that an employee's work is not done. Employees may choose not to attend work on days when various events (such as meetings and training and development programs) are being held. This places additional demands on existing staff and may cause even greater hostility within the workplace. Absenteeism costs Australian businesses more than $2.7 billion annually. The costs relate to the need to pay employees while they are off work, having to pay others to complete the absent staff members' work (either in the form of overtime payments to other staff or payments to a casual replacement brought in temporarily) and possible production losses.

Levels of disputation

Disputes at a workplace often reflect an unhappy workforce. The **level of disputation**, the seriousness of disputes and the frequency with which they occur indicate the extent to which employers are successfully managing the human resource function.

Source 17.4 Workplace disputes decrease management effectiveness.

The more disputes there are in a workplace, the less effective management is being in managing the human resource function. When disputes are frequent, employers need to examine why the disputes are occurring and rectify the practices that cause disputes.

Absenteeism Employees not attending work, usually for reasons such as illness or family responsibilities.

Accidents

Within any organisation, it is inevitable that human error may occur. Regrettably, this error may affect workplace health and safety. Workplace accidents occur across all Australian workforces and may range from minor concerns such as cuts and bruises to more serious issues, including permanent physical disability and death. Each year, more than 100 000 workplace injuries are reported to SafeWork NSW.

All workplaces across Australia must be aware of potential hazards. Management must then implement strategies to either eliminate or reduce these hazards. Effective human resource management ensures that work health and safety within a business is paramount.

Level of disputation The number of times each year issues arise between an employer and its employees.

Source 17.5 Management must implement strategies to reduce or eliminate hazards.

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Worker satisfaction

Worker satisfaction means that employees are contented at work, and that their job fulfils their needs and desires. Satisfied employees often work more efficiently and value the organisation that they work for. This concept of loyalty is reflected in happy employees who enjoy their work and coexist in a productive relationship with their supervisor.

Worker satisfaction The level of satisfaction demonstrated by employees towards their employer and the nature of the job tasks.

An effective human resource management structure will implement strategies to measure worker satisfaction. Based on the results of the data, management must then examine methods to improve worker satisfaction. This could range from a simple issue such as improved dining facilities to more long-term matters such as leadership styles.

Review 17.1

Cloze

Rewrite the following paragraph, using the words listed in the box to fill in the blanks.

seven	employees	best	management	measuring
against	work	frequency	dissatisfaction	leave
motivation	unhappy	standards		

The effectiveness of the employment relationship can be examined from _____ key perspectives. Staff turnover refers to the rate at which employees _____ a business. High levels of staff turnover can be a result of voluntary separation. This would be indicative of poor employment relations within the business. _____ express their dissatisfaction by leaving the business. Some employees use 'sick days' to express their _____ at the workplace. Employees may choose not to attend _____ on days when various events (such as meetings and training and development programs) are being held. Disputes at a workplace reflect an _____ workforce. The level and seriousness of the disputes and the _____ with which they occur reflect the extent to which management is successful in dealing with the human resource function. Quality refers to the extent to which employees are working to the _____ of their ability. It includes their attitudes and _____, as well as the level of effort placed in performing tasks. Benchmarking is the process of _____ an employee's performance _____ established standards. If employees are unable to meet these _____ on a regular basis, it is clear that _____ must examine the reasons for this.

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Source 17.6 In 2020, Cisco ranked as the #1 Fortune World's Best Workplace, repeating the feat for the second straight year.

Chapter summary

There are seven perspectives from which a business may measure the effectiveness of its employment relationship: staff turnover, absenteeism, level of disputation, benchmarking of key variables, accidents, corporate culture and worker satisfaction.

Corporate culture refers to the culture within an organisation. It relates to the values and beliefs within a business and directly influences the relationship between management and employees.

Benchmarking is the process of measuring an employee's performance against established standards.

A high level of staff turnover caused by voluntary separation is indicative of poor employment relations within a business. Employees may be expressing their dissatisfaction by leaving.

While most employees are absent for medical or family reasons, some employees use 'sick days' to express their dissatisfaction at the workplace.

The level and seriousness of the disputes and the frequency with which they occur indicate the extent to which employers are successfully managing the human resource function.

Worker satisfaction is used to describe whether employees are happy and contented, and fulfilling their desires and needs at work.

All workplaces across Australia must be aware of potential hazards. Management must then implement strategies to either eliminate or reduce these hazards. Effective human resource management ensures that occupational health and safety within a business are paramount.

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End-of-chapter tasks

Chapter revision task

Create a mind map based on the key measures of effective human resource management. For each measure of effectiveness, define the measure and explain how it is used to assess human resource management effectiveness. List two benefits and two issues of concern that each measure may result in.

Multiple-choice questions

1 A business is experiencing high levels of staff turnover.

As a result, which of these practices may managers also discover in the workplace?

A High levels of employee satisfaction
B Increased levels of industrial disputes
C High levels of employee productivity
D Increased levels of staff rewards

2 Which of these leadership styles could lead to low staff turnover?

A Authoritarian, as it allows employees less involvement in the decision-making process
B Authoritarian, as it recognises the skills of management in the decision-making process
C Participative, as it encourages employees to make use of their skills and expertise
D Participative, as it promotes a faster process in decision-making

3 A group of employees have decided to put minimal effort into their work in direct protest against management's decision to not upgrade lighting. Which measure of effectiveness could management use to determine the employees' response?

A Absenteeism
B Level of staff turnover
C Quality
D Benchmarking

4 Which of the following measures of human resource management effectiveness would improved training and development initiatives seek to address?

A Benchmarking
B Disputation
C Absenteeism
D Quality

5 Which of the following best describes the role of corporate culture within an organisation?

A The values within a business that are reflected through management behaviour and policies
B The values within a business that employees are expected to abide by
C The values within a business that all stakeholders are expected to follow
D The values within a business that are reflected through employee behaviour

6 Due to a lack of concern regarding occupational health and safety, a number of employees have experienced workplace injuries. Which of the following indicators is reflected through this?

A Corporate culture
B Accidents
C Level of disputation
D Staff turnover

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7 Which of the following would improve worker satisfaction within the workplace?

A Improved communication between employees and line managers
B Improved business profitability and reduced employee working hours
C Decreased labour costs and increased employee responsibilities
D Increased staff supervision and decreased work–life balance options

8 Ineffective staff training initiatives have seen employees in a business fail to achieve set sales targets for the past two months. Which indicator is this reflective of?

A Benchmarking of key variables
B Level of absenteeism
C Corporate culture
D Worker satisfaction

9 Management of a business is becoming increasingly concerned with the number of days of leave staff have been taking. Which indicator is this reflective of?

A Benchmarking of key variables
B Level of absenteeism
C Corporate culture
D Worker satisfaction

10 Which of the following would improve the ability of staff to reach benchmarked standards within a business?

A Improved training and development strategies
B Decreased channels of communication within the business
C Increased monetary rewards
D Decreased promotional opportunities for junior staff members

Short-answer questions

1 Discuss the impact of leadership styles on corporate culture and levels of disputation in the workforce.

2 Examine the effect of staff absenteeism on quality and benchmarks in a workforce.

Extended-response question

Identify the importance to a business of examining indicators of effective human resource management and explain the role of each indicator in human resource management.

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Case study – Cochlear Limited

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18 Cochlear Limited: Introduction

This textbook contains a whole-year case study on Cochlear Limited with a chapter devoted to each topic covered.

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18.1 Hear now. And always

Professor Graeme Clark, an ear surgeon, set out to create the first multi-channel cochlear implant after seeing his father, a pharmacist, struggle with hearing loss that caused hardship and isolation. Clark collaborated with other researchers for more than 10 years – he took up his role at the University of Melbourne in 1967, implanted the first prototype in 1978 and handed over to the Nucleus group to develop the first commercial device in 1981. In the late 1970s, Clark realised that there was a safe way to insert electrodes into the inner ear. His breakthrough solution ultimately connected people worldwide to a life of hearing.

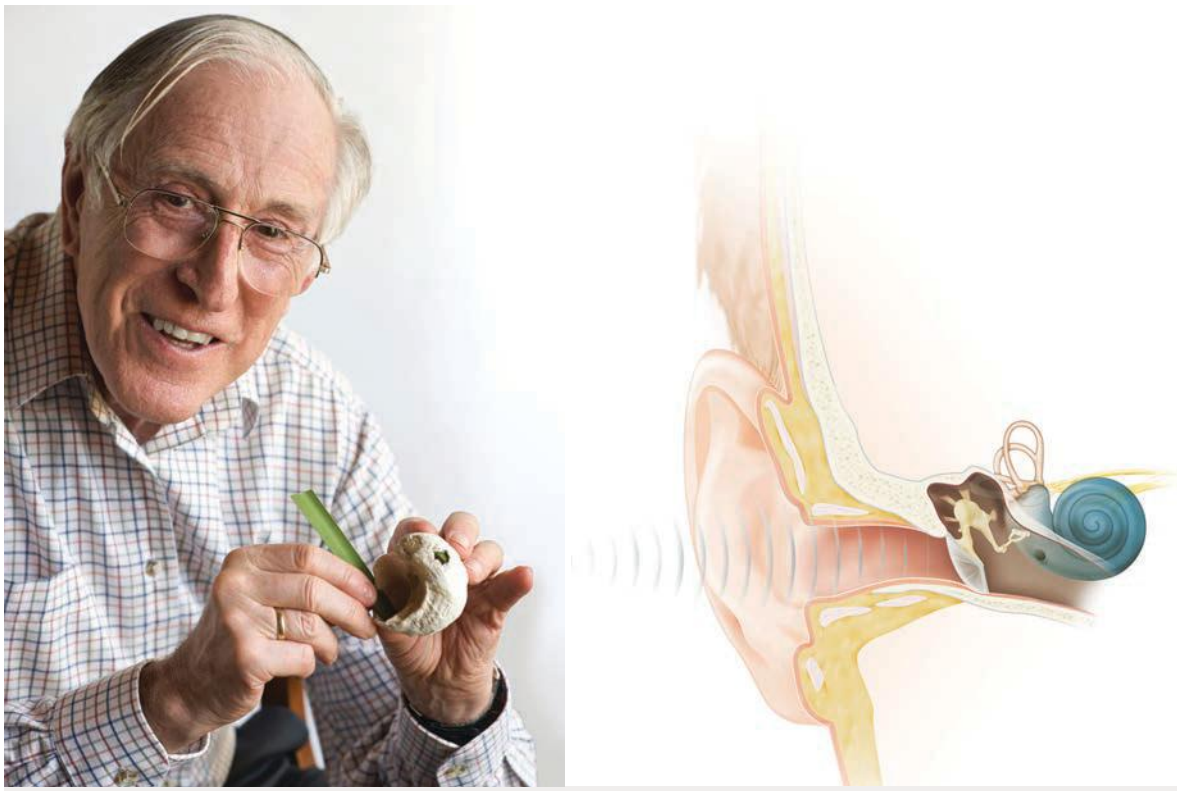
Cochlear began its operations in 1981 as part of the Nucleus Group, after receiving an Australian Government grant of A$4 million to start commercial development of the multi-channel cochlear implant. In March 2021, the World Health Organization (WHO) estimated that there were more than 1.5 billion people worldwide who live with hearing loss.

Cochlear's prime function has always been to provide hearing support to as many people with hearing loss as possible through implantable hearing devices. In its mission statement, Cochlear states:

> *We help people hear and be heard.*
>
> *We empower people to connect with others and live a full life.*
>
> *We transform the way people understand and treat hearing loss.*
>
> *We innovate and bring to market a range of implantable hearing solutions that deliver a lifetime of hearing outcomes.*
>
> Source: Cochlear Limited, 2021.

The global headquarters of Cochlear was established in Lane Cove, Sydney in 1981. The Macquarie HQ was not built until 2010. Prior to that Cochlear was based in Lane Cove. In 1985, Cochlear's first overseas office was established by a small team in Colorado, United States. Another overseas office was established in 1987 in Switzerland. At this time, Cochlear was growing rapidly with over 500 employees, 100 of whom were based in Europe. Cochlear opened its office in Japan in 1989, two years before any Cochlear™ product had received approval in the region.

Video 18.1 Professor Graeme Clark explains how his father's hearing loss inspired him to create the first multi- channel cochlear implant.



Source 18.1 Professor Graeme Clark found inspiration for his design when threading a blade of grass into a seashell.

Video 18.2 How does a Cochlear Implant work?

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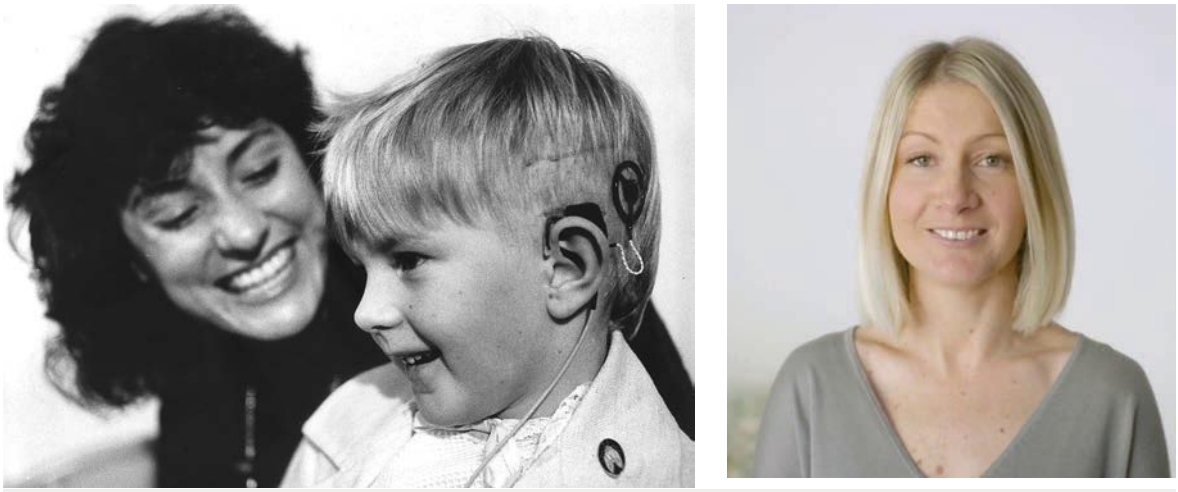

Source 18.2 In 1987, Holly McDonnell was the first commercial paediatric recipient at the age of four, after losing her hearing due to meningitis. Holly's successful attendance at mainstream schools and university to pursue a career in law is the embodiment of Cochlear's mission statement.

The 1990s saw rapid growth with the milestones of 5000th, 10 000th and 21 000th recipients of the multi-channel implant during the decade. Cochlear Limited was floated as a public company on the Australian Securities Exchange on 4 December 1995. In 2010 Cochlear moved to a new purpose-build headquarters on the Macquarie University campus, NSW.

Cochlear®

Hear now. And always

Source 18.3 Cochlear logo

By the end of the 2019 financial year, Cochlear Limited had become a biotechnology company that designs, manufactures and supplies implants including cochlear implant and acoustic implants, which healthcare professionals use to treat a range of moderate-to-profound types of hearing loss.

Source 18.4 Cochlear's market-leading product portfolio as at 30 June 2019.

Cochlear has developed a reputation for producing the highest-quality products and providing the highest level of service to its customers, in more than 180 countries. It is a large company with more than 4000 employees and direct operations in over 30 countries. It now has six global manufacturing facilities.

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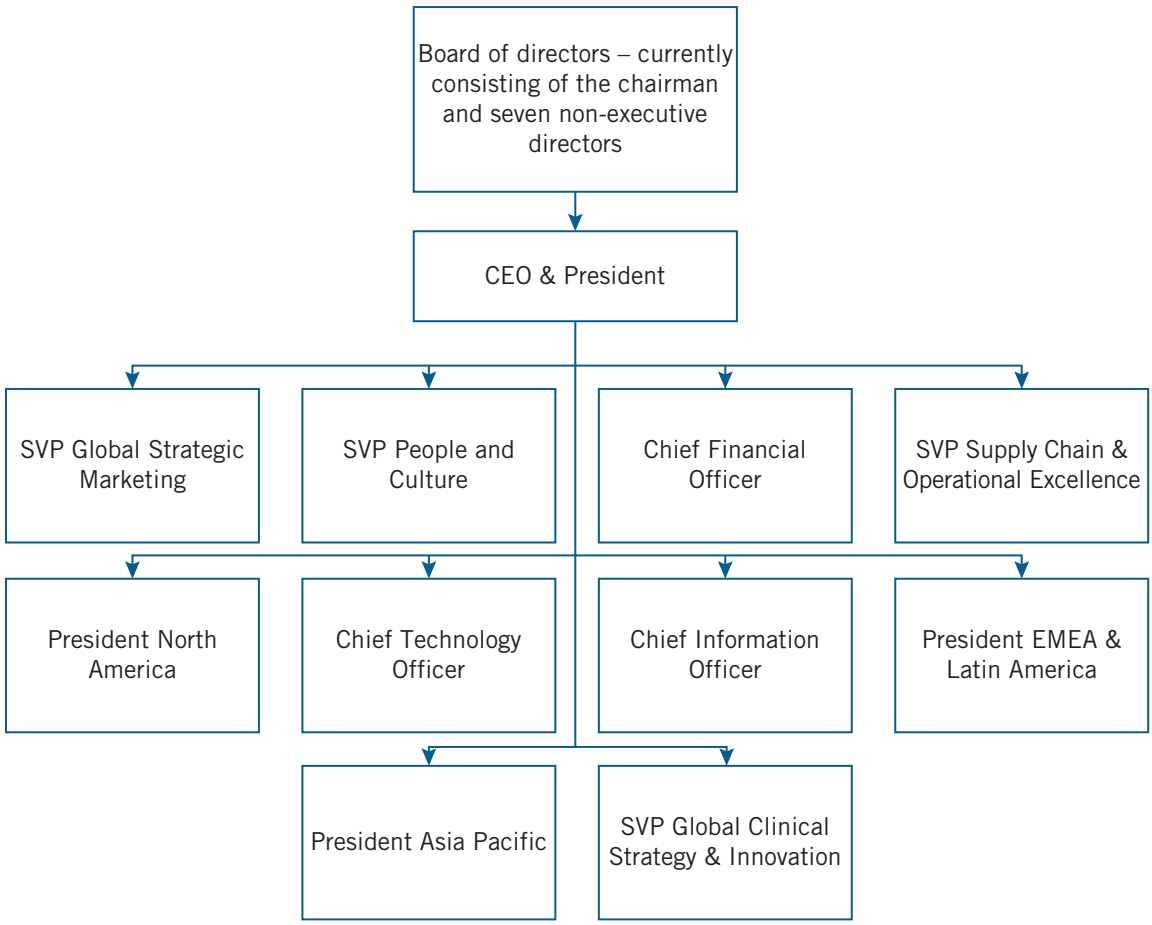
Source 18.5 Cochlear's global manufacturing and direct operations locations

Cochlear's management and organisational structure is regional based. The board of directors oversees execution of the company's strategy and determines the direction for future business planning. Additionally, Cochlear has specialists in marketing, manufacturing and logistics (operations), People & Culture (human resources), technology, finance and medical information.



Source 18.6 Cochlear's organisational structure as at June 30, 2019

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Source 18.7 Cochlear's strategic priorities for 2021

Cochlear's aim is to grow the hearing implant market and strengthen its servicing capabilities in order to support the lifetime relationship with its recipients of hearing implants.

Cochlear's strategic priorities are outlined in Source 18.7.

Cochlear is the world leader in implantable hearing solutions, with a very strong reputation for quality. It is also the current technology leader in the industry, with more than A$2 billion invested in research and development over its lifetime to support its global market leadership. Cochlear's current major competitors are:

- MED-EL, a long-time cochlear implant manufacturer and an innovative hearing implant company
- Oticon, founded in 1904 in Denmark as an importer of hearing aids. In 2013 the company acquired a French manufacturer of cochlear implants to become, at the time, the only company that made hearing aids, cochlear implants, and bone-anchored hearing aids.
- Advanced Bionics, the US-based sister company of Phonak – both owned by the same parent company, Sonova AG.

In 2019, Cochlear was a top 50 listed Australian company with a market capitalisation of over A$10 billion, representing the total value of all Cochlear shares. It had an annual revenue of approximately A$1.4 billion for the 2019 financial year and has provided more than 600 000 implantable devices so far.

Cochlear's recognition of the needs of its customers drives its collaborations with medical research to continuously improve outcomes in its next generation products. The need for hearing implants for seniors (over 65 years) due to an ageing population, and hearing loss and its potential association to cognitive decline, social isolation, depression and loss of independence has grown. Cochlear is gifting US$10 million over 10 years to the Johns Hopkins Bloomberg School of Public Health to establish the Cochlear Center for Hearing and Public Health, and sees hearing loss as a global public health priority.

As more emerging economies increase in wealth, Cochlear's expansion has targeted building awareness through education campaigns and hearing screening for children in these locations. By creating more awareness of implantable hearing solutions, Cochlear can grow the hearing implant market and provide solutions to more people around the world. Currently the market leader in the Asian market, Cochlear recently built a state-of-the-art manufacturing

An ABC News interview with Professor Graeme Clark can be viewed here: https://cambridge.edu.au/redirect/9701

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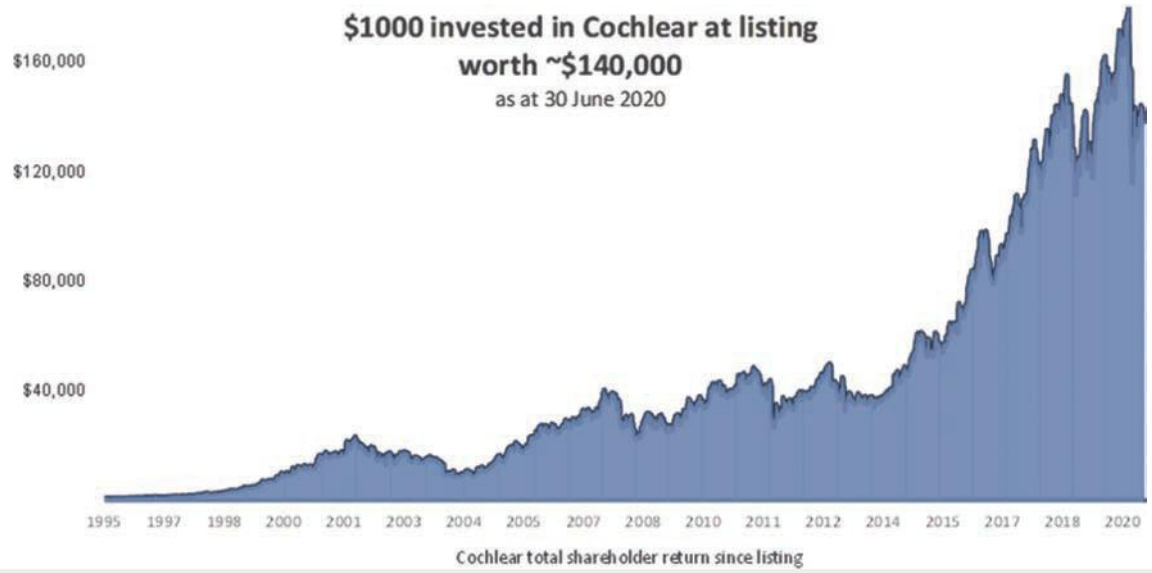

Source 18.8 Cochlear total shareholder return since listing, as at 30 June 2020

facility in Chengdu, China, aimed at meeting growing demand within the region.

Cochlear is very community-based and works to establish community centres, educational facilities and environmentally friendly workplaces. It tries to grow a positive relationship with local and global communities and develop new products that exceed customer expectations while delivering consistent revenue growth and return to shareholders.

Source 18.9 Cochlear implants enable students to fully participate in team sports.

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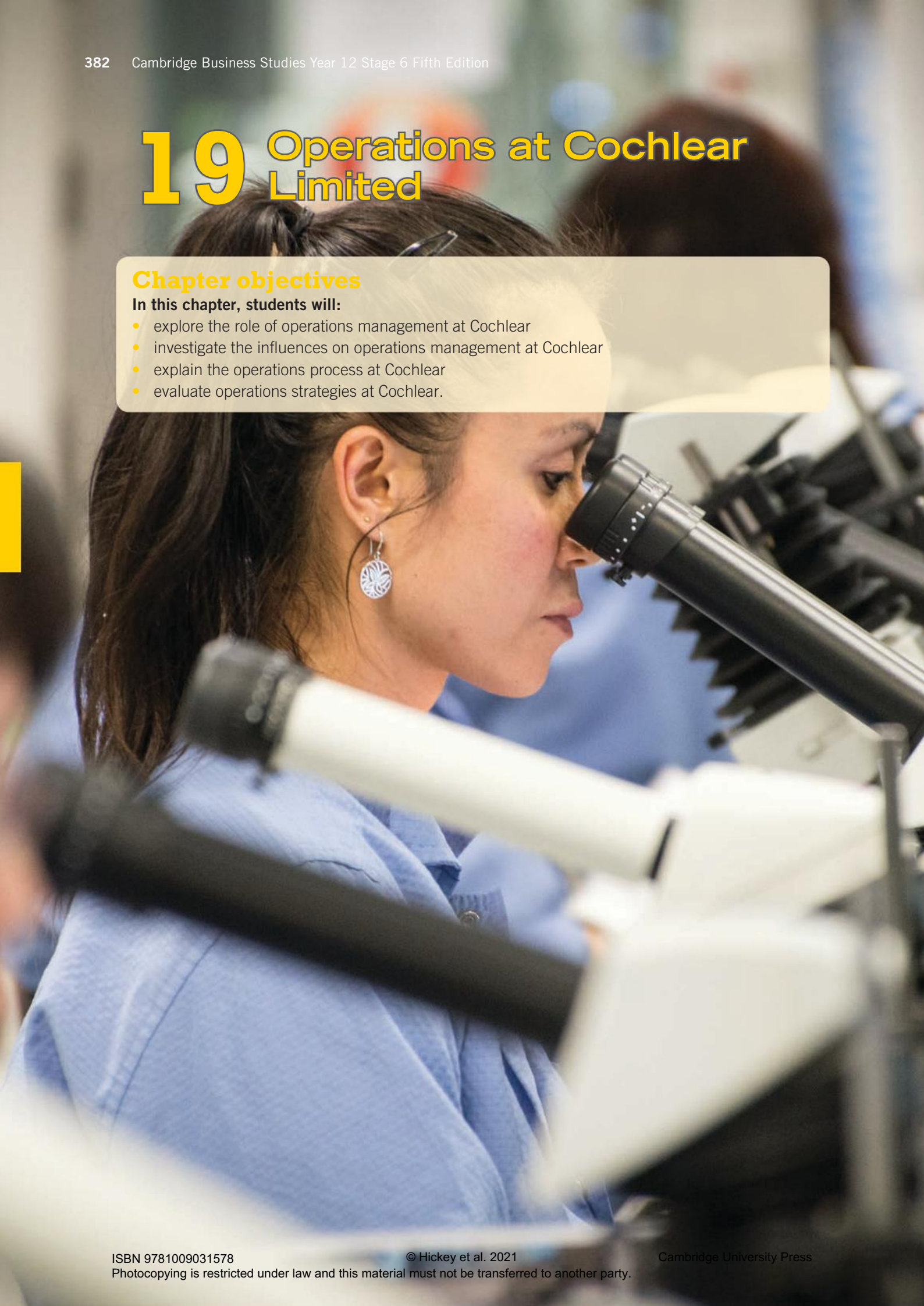
19 Operations at Cochlear Limited



Chapter objectives

In this chapter, students will:

- explore the role of operations management at Cochlear
- investigate the influences on operations management at Cochlear
- explain the operations process at Cochlear
- evaluate operations strategies at Cochlear.

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19.1 Role of operations management

Ultimately, the role of operations management is to support the achievement of strategic profitability and growth. For Cochlear, operations is critical to achieving its mission statement.

Operations was central to the business's origins. Inventor of the multi-channel cochlear implant, Professor Graeme Clark, spent years developing prototypes and innovating manufacturing techniques to develop a commercially viable multi-channel cochlear implant. Operations at Cochlear includes research and development, quality management, and manufacturing and supply chain. The goal is to develop and make industry leading products at an affordable cost. Cochlear's range of products includes cochlear implants, bone conduction implants and active osseointegrated steady-state implants that treat a range of different types of hearing loss. The service component of operations includes a variety of information and resources designed to help recipients, and the professionals they work with, develop or relearn listening and language skills.

Thus, the role of operations is significant to achieving marketing objectives while at the same time managing costs to achieve financial objectives. Profitability and long-term growth are key financial goals for shareholders. Product innovation, service and improving the quality of life of its customers are the company's key social goals.

Video 19.1 Cochlear collaborating for change

Differentiation through operations has been achieved through:

- quality and reliability
- incorporation of new technology
- speed of distribution and repair service
- safe design
- continuous product innovation.

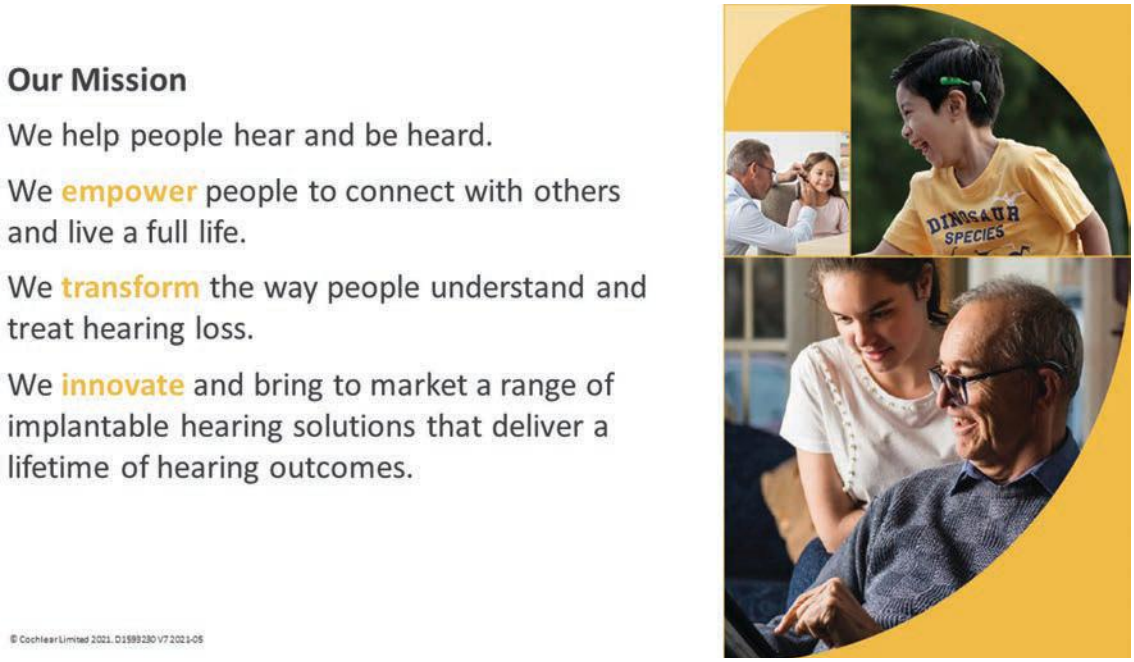
Cost leadership through operations is achieved through:

- targeted business efficiency programs
- economies of scale in manufacturing
- global manufacturing and the repair facilities.

19.2 Influences

Globalisation

For Cochlear, globalisation has created opportunities to access the global market to sell the outputs of its operations. Europe, Asia and North America are key markets. China is an emerging market. Cochlear is a Sydney-based company with global operations. As a globalised business, development and design is carried out in Australia, Belgium, Sweden and the United



Source 19.1 The Cochlear Limited mission statement

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States. New manufacturing facilities have been established in China and in Malaysia, to support global demand and expand access. The company also collaborates with more than 100 research programs worldwide. Cochlear collaborates with other global technology companies, such as GN Hearing in Denmark, a hearing-aid manufacturer, to benefit from joint research and commercial arrangements. Globalisation has enabled Cochlear to vertically integrate its business by acquiring Sycle, the USA leader in audiology practice management software, in 2017. Sycle software is used by over 7000 clinics in the United States, the United Kingdom and Canada, giving Cochlear a powerful tool to increase its global presence.

However, the benefits of globalisation also bring risks. There are new threats, such as other lower-cost manufacturers that can serve the same markets. Global 'shocks' such as pandemics, natural disasters and terrorism can also impact supply chains.

Technology

Technological developments in medicine, medical equipment manufacturing, electronics, and wireless accessibility have had the most significant impact on Cochlear. The company maintains its market leader position through technological innovation in its products, manufacturing methods and service delivery. In 2020, Cochlear launched the Osia(R) System, which has a Piezo Power™ transducer and is a completely different design from traditional bone conduction implants, providing superior performance. The internet and smartphones have revolutionised how Cochlear delivers its services. Its website has a comprehensive range of videos, downloadable documents and interactive resources. It is now possible for Cochlear to remotely test and diagnose equipment problems. Manufacturing innovations have reduced costs and improved quality. Electrode arrays are handmade for most steps in the process; however, robotics can be increasingly used in delicate operations processes in Cochlear's state-of-the-art manufacturing facilities. Overall, technology has significantly increased the speed of operations and achieved high standards for quality outputs so that Cochlear's products have superior performance and reliability.

Despite all these technological breakthroughs, Cochlear must ensure that new technology in production is tested and does not disrupt the delivery of outputs.

Quality expectations

Operations must satisfy the expectations customers have for sound quality, comfort and convenience. In terms of design and manufacturing, Cochlear has the world's smallest and lightest behind the ear sound processors and the world's thinnest cochlear implant at 3.9 millimetres. In terms of services, hearing health professionals expect

Source 19.2 Cochlear is a global business. Manufacturing sites as of June 2020.

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wireless connectivity, ease of access for support, and a range of easy-to-use rehabilitation tools. In addition, there is the expectation that the device will continue to operate for many years at the same standard of performance since it was first implanted. High implant reliability can mean greater recipient satisfaction and less risk of additional surgery, particularly important for children. Operations must support Cochlear's value proposition so that it produces market-leading products and services that inspire confidence in its customers.

Poor operations will not achieve these objectives, and Cochlear would lose customers to its competitors as well as impacting on their quality of life. Data support the claim that Cochlear products set the standard in reliability.

Competition

In Australia, the cost to healthcare providers of cochlear implants and devices can be between A$25 000 and A$50 000. However, the product itself and the implant surgery are covered by Medicare, the government's public health service or private health insurance. Therefore, competition is based on product choice, features and quality, rather than cost. Cochlear Limited has three competitors that also offer cochlear implants in Australia: MED-EL, Oticon Medical and Advanced Bionics. To maintain competitiveness, Cochlear aims to differentiate its product, implement new technology and form strategic alliances with research partners to continuously innovate. For example, collaborations with Google and Apple have led to the development of devices incorporating Bluetooth so that customers can stream music and other audio from Android and Apple devices directly to their cochlear implants. Several start-up companies are also developing advanced and low-cost multi-electrode cochlear implants, including Advanced Cochlear Systems in Seattle, Washington, and Nurobiosys Corporation in Seoul, Korea.

Government policies

There are two macroeconomic influences on the business. These include the rising cost of labour and health-care costs in Australia and globally. High labour costs add to manufacturing costs in Sydney and Brisbane. Currently, cochlear implants are 'paid for in part' through the taxation system as they are funded by Medicare or through private health care. A downswing in the business cycle could be a significant economic influence owing to the relatively expensive nature of elective medical procedures and private health insurance. In 2019, more than 9000 Australians opted out of private health insurance, increasing the financial burden on the government to provide health services. If the government removed cochlear implants from the benefits list, far fewer people would be able to pay the full retail cost. However, given the essential nature of the product and its cost-effectiveness (an implant can save A$50 000 to A$100 000 in additional government financial support for profoundly deaf people) continued government support will ensure that domestic sales are not impacted by the economic conditions in Australia.

Video 19.2 Choose quality for today and tomorrow with a hearing implant from Cochlear

Legal regulations

As well as Australian consumer law and environment protection legislation that apply to most Australian businesses, Cochlear must comply with strict laws that regulate how medical devices are made and sold.

In Australia, medical devices are regulated by the Therapeutic Goods Administration (TGA). The TGA enforces laws that manage how Cochlear must:

- assess medical devices for their safety and quality
- publish information about approved products in the Australian Register of Therapeutic Goods
- monitor medical devices after they have been approved to make sure they continue to meet quality and safety standards, and are doing what they said they would do
- take action if there is an issue with a medical device – such as recall a medical device, or issue new guidance to patients.

There are similar laws and organisations that regulate medical devices in other countries around the world that Cochlear must comply with in every country they sell medical devices in.

Corporate social responsibility

Cochlear has also recognised the importance of sustainability in all aspects of its operations, and publishes its environment performance

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data for energy use, water and greenhouse gas emissions. Accurate data is collected to measure environmental impacts to identify areas for improvement. This data is published annually in Cochlear's Sustainability Report. In addition, the company also assesses its suppliers to ensure that they also operate in a sustainable and ethical manner.

Cochlear's own assessment in 2020 concluded that the company was not exposed to any environmental risks to its operations. Cochlear's Environmental Management System has clear environmental objectives for operations. It follows the International Standard ISO 14001. Cochlear's manufacturing operations currently only produce low-level emissions, and the company will focus on continuing to reduce its impacts. Greenhouse gas emissions are expected to fall in the future. In 2020, emissions per device made in current sites, measured in kilograms of carbon dioxide equivalent (CO2-e), were 61 kilograms, a fall from 67 kilograms in 2019.

As part of the company's long-term commitment to reducing carbon emissions, it plans to use more energy from renewable sources. Currently, the company can generate 17 per cent of its energy from solar panels installed on its manufacturing sites. Solar panels installed on its headquarters at Macquarie University in 2019 are able to generate 220 megawatt hours (MWh) of solar energy.

During the COVID-19 pandemic, the company reduced its business flights and intends to continue to rely less on international travel as part of its contribution to managing global climate change. Other initiatives include more recycling of paper, plastic, glass and metal at its sites, and reducing use of single-use plastics.

19.3 Operations processes

The operations processes at Cochlear involve changing inputs into outputs to create satisfied customers who have confidence in the quality and performance of Cochlear's products. The outputs of operations are used by the businesses that provide hearing services, clinics, audiologists, specialist surgeons, governments that fund the health services, and the people who use Cochlear's devices.

Inputs

Materials

The hearing device comprises an internal implant, which includes a receiver, electronics and an electrode array, and an external sound processor in a protective case. The electrode array is made up of wave-shaped wires made for strength and to resist corrosion. Each wire is approximately one-quarter the width of a human hair and the array is embedded in silicon. The sound processor is made from a plastic moulded casing, and contains electronic components, including signal processing circuits, wireless links, and microphones. A selection of rechargeable or single-use batteries powers the unit. The final material component is the link between the external processor and the implant, which is achieved via internal and external magnets. Silicon is used extensively to seal and protect each component because silicon is biocompatible, meaning it does not cause an adverse reaction when in contact with the human body. Other biocompatible materials used as inputs include titanium and gold.

Information

Cochlear relies on current and accurate information to organise its operations in the most efficient manner. Sophisticated project management software analyses every task performed to minimise time lost and ensure inputs are available at the right time, in the right place and in the right amount. During manufacturing, information from testing is analysed as a quality control strategy. Following activation, customer survey results can

Source 19.3 The outputs of operations

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be transformed through analysis to determine changes and improvements to Cochlear's products and service. Information and data for device performance and failure rates published by Cochlear are analysed to identify potential risks and improve device safety. Cochlear's research partners will also provide information to improve efficiencies and quality in manufacturing.

Customers

Customers are an input because they provide feedback on the effectiveness of the implant and sound processor software. Each patient is unique, and therefore considerable fine-tuning and individualised support are needed so that patients can get the most from their implant. Qualitative data is collected from patients, such as suggestions and advice about what services, tools and support will assist future recipients. Quantitative data is collected using analytics to monitor how the Cochlear website is used by customers and which parts need more development.

Human resources

Cochlear has more than 4000 employees in over 35 countries. Highly skilled specialist staff are used for all aspects of Cochlear's operations: audiologists, clinicians, researchers, software engineers and manufacturing engineers. In addition, the company works with top hearing professionals around the world.

Facilities

The most obvious of Cochlear's facilities is its global headquarters at Macquarie University in Sydney, adjacent to the Australian Hearing Hub. This health precinct is a one-stop-shop for clinical evaluation, testing and diagnosis. Products are designed and manufactured here. The manufacturing rooms are much like laboratories. There are additional facilities globally. Cochlear bone anchored solutions are designed and manufactured in Gothenburg, Sweden. There are manufacturing and repair facilities located in Malaysia. A new manufacturing centre has recently been built in Chengdu, China. From these manufacturing and repair centres, products are distributed to more than 180 countries around the world.

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Transformation processes

Cochlear implants require a unique combination of human-made and technological processes. Production uses a functional process layout where implants are made separately to sound processor assembly. Accessories are primarily manufactured in Brisbane or outsourced to third-party suppliers. All equipment and machinery are arranged in the factory by function. Implants and sound processors are manufactured using both flow and batch processing that involve some automation, which is possible due to the standardised nature of the product. Implants are sterilised and released in batches.

The electrode arrays for each implant are handmade in 'clean-room' laboratories which are 12 times cleaner than an operating theatre. This is because the electrode arrays require expert skills and must be completely free from any contamination that could cause health problems when implanted. This part of operations is labour-intensive because each wave-shaped wire is individually placed and lined up so that it stimulates a certain range of sounds. There are up to 24 wires in a single electrode array. Once all the wires are correctly positioned, the form is sealed up and a special mix of silicone is injected inside. A completed batch of electrode arrays is put in a benchtop oven to heat and solidify the silicone.

Volume, variety, variation in demand and visibility

Cochlear is no different from other businesses in that its operations are strongly influenced by the four Vs. Of the four Vs, variety is the most significant influence. Being a large company, Cochlear manufactures thousands of units a year and currently offers three main systems and a wide range of accessories. The company also supports older models and manufactures different variations of existing models. Variety is therefore high. For the implants themselves, Cochlear has a range of electrode arrays available. Each of these arrays has a different length, shape or design, to suit surgeons' preferences.

Volume of output is steadily growing. Approximately 35 000 cochlear implant units were produced and sold in 2018 and 2019. It is anticipated that the market will continue to expand with growth in emerging markets and ageing populations in developed countries where hearing loss is highest in the over 65 year age group.

Variation in demand is low because there is no seasonal effect. The manufacturing operations are not visible to customers. Customer contact occurs when support, maintenance and repair services are required, and this occurs via the website, telephone, email or via hearing health clinicians.

Source 19.5 The clinically sterile laboratories where cochlear implants are manufactured

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		Job production	Batch production	Flow using assembly lines	
Volume	Low volume	←	✕	→	High volume
Variety	High variety	←	✕	→	Low variety
Variation in demand	High variation	←	✕	→	Low variation
Visibility (customer contact)	High visibility	←	✕	→	Low visibility

Source 19.6 The four Vs as they apply to Cochlear Limited

Sequencing and scheduling

Sequencing and scheduling at Cochlear is data-driven and organised by internal manufacturing planning software. Critical path analysis (CPA) is used to identify the shortest production time. The electrode array is made at the same time as the sound processor. To ensure quality, component testing is built into the operations processes. Manufacturing medical devices is complex, and the last step is micro-joining and welding of coils to terminal pins, laser-seam welding thin titanium housings, and spot welding of thin electrode rings to interconnect wires. Once sealed, a final silicon layer is added for protection.

Outputs

Cochlear implants help improve the hearing of those customers with severe to profound hearing loss. The company has a comprehensive portfolio of products and services, including implants, sound processors, fitting software for clinicians and apps for both Android and Apple devices. The implants and processors are supplied directly to surgeons and hearing clinics. Customers can also purchase accessories, such as:

- True Wireless™ Mini Microphone, Phone Clip and the TV Streamer, which enables users to stream sound directly to the sound processor
- Aqua+ reusable silicone sleeve to make the processor waterproof for swimming
- a range of clips and headbands to secure the processor during physical activities.

Services are consumed over years.

Source 19.7 Outputs for use by final consumers, clinics and surgeons

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Customer service

Cochlear has three different market segments for its customer services output: health professionals, the people who use its devices, and their families. In the business-to-business (B2B) context, Cochlear provides services to the health professionals who use and promote Cochlear products. Its website offers surgical guides and training videos as well as online training courses for each of its products and analysis of industry trends. Audiologists and other health professionals can use the online myCochlear.com to access all the tools and resources needed to provide optimal care at every stage of a patient's journey. Clinicians can manage patients using Cochlear's own patient software management system, watch step-by-step troubleshooting videos as well as log requests for repair or replacement of devices. In addition, Cochlear provides assistance with information about making insurance claims and marketing information.

Cochlear anticipates a lifelong relationship with its customers, and therefore service and support is a key point of differentiation. For the people who receive their implant and their family, customer service can be grouped into three areas:

- initial support after the device has been switched on
- education and emotional support
- upgrading, troubleshooting and repair.

This support can be accessed through the Cochlear website, where fast and convenient tools and resources are available. In the US, Cochlear aims to increase its market share through its support program called Cochlear Care. These are a range of personalised services that cover each part of the customer journey and are designed to improve the user experience. Individuals' programs cover:

- education programs for pre-teens, teens, parents and adults
- insurance support
- technical support (phone, online chat and frequently asked questions)
- telephone training to improve confidence
- a mentor program.

Specific rehabilitation resources are also available through the website to help parents with young children who have received an implant. For example, a video, booklet and worksheets have been developed and supplied by Cochlear to help parents coach their young children to develop their skills in spoken language for daily life.

The mentor program is unique to Cochlear. New users are matched through Cochlear's online tool with someone who has experienced a similar personal hearing journey. This program reduces the anxiety that some new users may experience.

Warranties

Cochlear stands by its quality claims in addition to any statutory warranty that protects consumers from defective materials or workmanship. It covers the cost of service and repairs within the warranty period if the product has not been misused, altered, mishandled or had an unauthorised repair. Products that need repair are sent to Cochlear's global repair centre and assembly centre for replacement sound processors in Kuala Lumpur, Malaysia. In addition to any local consumer laws of the country that Cochlear's products are sold in, the company offers a 10-year warranty on the Nucleus® Cochlear Implant and the Nucleus Auditory Brainstem implant from the date of surgery, three years for the processor and one year for the 'system' accessories such as the battery. Customers can also choose a service plan to help reduce the costs of service and repairs for their sound processor once it is out of warranty.

19.4 Operations strategies

Quality is the key point of differentiation. However, competition from lower-cost competitors and pressure on governments to use their finances to subsidise medical devices in a cost-effective way create pressure on Cochlear to sell competitively priced devices. The challenge for operations is to achieve all performance objectives with only appropriate compromise.

Performance objectives

Of all the performance objectives – quality, speed, dependability, flexibility, customisation and cost – dependability and quality are the most important to Cochlear.

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Cochlear's quality objective is to improve the hearing outcomes of its patients. So, for example, surveys by Cochlear indicate that 86 per cent of paediatric patients using the new Baha Attract system rated their understanding of speech to be good or very good. Secondly, there is the objective of minimising the defect rate of the implant to avoid additional surgery and reimplantation.

Dependability is strongly related to reliability, or how long the implant will last. Implant reliability data that is collected and published by companies in the industry must comply with the reporting methodology recommended by the CI86:2017 Cochlear Implant Systems: Requirements For Safety, Functional Verification, Labeling And Reliability Reporting standards set by the Association for the Advancement of Medical Instrumentation in conjunction with the American National Standards Institute. Cochlear's products are reported as the most reliable in the industry. Dependability is measured using Cumulative Survival Percentage (CSP). CSP is used to measure the reliability of each make and model over time. For example, a CSP of 99 per cent after five years means that the chance of obtaining continued benefit from the cochlear implant, as described for its intended use, is 99% after five years.

Speed of operations is assessed by how long it takes to manufacture a device. The manufacturing process for the electrode array is very labour-intensive. Considerable testing is required. Therefore, the quality performance objective is more important. As an objective, speed in shipping a finished unit from a warehouse within 24 hours can be achieved.

Flexibility in operations is less important as a performance objective. This is because the different sound processors available are compatible with different generations of implants. In 2019, cochlear implants represented 58 per cent of sales; services are 30 per cent and acoustics the remainder; and operations has the flexibility to increase service and acoustics output if there is more demand. Operations also has geographic flexibility. In 2019, 48 per cent of sales was directed to the United States, Canada and Latin America; however, Cochlear's globalised operations can meet rising demand in new European and emerging markets as it occurs. During the COVID-19 pandemic, demand fell and output was scaled back to approximately 31 000 units. This meant that there was excess capacity in manufacturing, which was able to meet increased demand in 2021.

The variety of accessories helps customers 'customise' their device. For example, the sound processor magnets are available in different strengths to suit individual needs. Skin and hair thickness can impact optimal magnet strength. It is possible to match the external processor to individual skin colour. A range of accessories helps customers customise their device to suit their daily life.

By increasing the scale of operations, cost per unit is expected to fall. Given that there is a strong incentive for governments and healthcare organisations to purchase devices at lowest cost, lowering manufacturing costs will support profitability and returns to investors.

New product design and development

Each year, Cochlear commits on average 12 per cent of sales revenue to be invested in new product design and development. The company also partners with academic institutions, start-ups, and innovators in health technology to develop innovations in the science of hearing. In 2020, Cochlear fast-tracked the development and launch of Remote Check, which uses a compatible iOS device such as an iPhone to enable patients to test and check their Nucleus 7 Sound Processor at home.

Cochlear is constantly improving its service and developing new products. In 2018, the company began a clinical feasibility study in Australia to evaluate a totally implantable cochlear device that can be used without an externally worn sound processor. A commercially available product is not expected for some years.

Supply chain management and inventory management

Effective supply chain management and logistics can be a business's strengths, as well as ensuring that parts and accessories are available and ready for each patient with a day's notice. Each manufacturing and distribution centre has an onsite warehouse.

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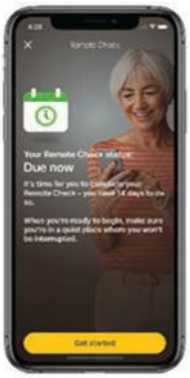
Remote Check solution for cochlear implants

Remote Check is the first telehealth patient assessment tool for cochlear implant recipients. It is designed to be a convenient, at-home testing tool that allows people with a Cochlear™ Nucleus® 7 Sound Processor to complete a series of hearing checks from their compatible iOS device using the Nucleus Smart App. Results are then sent remotely to the recipient's clinic for review by their clinician.

Remote Check was developed to conduct routine cochlear implant checks outside the hearing clinic. The technology has been tested in previous pilots in five countries worldwide. Following increased demand for remote care due to the COVID-19 pandemic, the FDA expedited its approval.

Remote Check provides recipients with the ability to continue to access a level of care at a time when many clinics are closed to in-person visits. The FDA's expedited approval of Remote Check during the COVID-19 crisis underscores the importance of remote hearing care solutions – now more than ever – with many healthcare authorities already recognising the value in reimbursing Remote Care consultations for clinicians.



Convenient, at-home testing for people with a Cochlear™ Nucleus® 7 Sound Processor

Source 19.8 Cochlear developed a revolutionary new program that can keep both patients and professionals connected as well as improve patient monitoring.

For manufacturing, parts are ordered directly from vendors and suppliers. Inventory is held on-site to ensure supplies are available for manufacturing. First in, first out (FIFO) is used as standard, for best practice, and to manage the shelf-life (expiration) of certain products.

Supply chain management also requires picking and shipping orders, receiving returns and dealing with vendors such as hearing clinics. Cochlear aims to ship orders the same day as the customer's order. Speed, accuracy and customer-friendly service are key performance objectives for supply chain management.

For example, in 2016 the Cochlear America centre:

- managed more than 200 000 customer orders every year
- delivered approximately 1.3 million different pieces of equipment.

A breakdown or delay in the supply chain has the potential to impact a customer who may have to go without being able to hear for some time.

Outsourcing

Cochlear outsources some of its operations processes, for example, components, assemblies and accessories. Distribution is also outsourced in some markets. Suppliers are carefully selected to ensure that Cochlear's products meet the highest standards of quality and to protect its intellectual property.

Technology

Cochlear has always been a developer of leading-edge technology. Cochlear was the first organisation to have a multi-channel cochlear implant approved by the US Food and Drug Administration. Other examples of leading-edge technology developed by the company were dual microphones and smartphone connectivity. Cochlear sees constant innovation as a key strategy to market leadership with professional health partners and enhancing the quality of life of its customers. However, developing leading-edge technology into viable commercial products requires significant financial commitment; A$2 billion had been committed to research by 2020. In terms of established technology, the cochlear implant has been developed over many years as an effective and long-term solution for people with severe to profound hearing loss. Cochlear pioneered the implant technology and is still the world's industry leader.

Quality management

Quality is essential within Cochlear's operations. The quality management system at Cochlear exists to help the company develop and maintain

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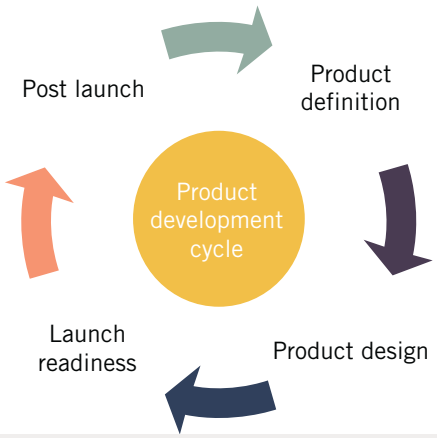
products that are safe, effective, reliable, and easy to use for both hearing implant recipients and the healthcare professionals that administer them. Quality management also helps Cochlear to meet regulatory requirements mentioned earlier in this chapter. There are many different processes that contribute to quality at Cochlear. These can be broken down into:

- What benefit the product should offer
- How it is designed to meet the intended use in a safe and reliable manner
- Getting the product ready to launch
- Evaluating and monitoring the product after is has been launched



Source 19.9 The product development cycle at Cochlear Limited.

The purpose of the Product Definition Phase is to refine the strategic intent of the product and define an agreed concept to be developed. It is a key planning phase before a product can be designed. The main question to be answered in this phase is 'what needs the product should fulfil?' For example, it may be a cochlear implant that has the best reliability on the market. The definition phase also aims to answer questions like 'what evidence will regulators need to approve the product as safe and effective?', 'can it be made at a cost-effective price?' or 'what risks could there be in executing this project?'

By the start of the Product Design Phase the strategic intent, marketing needs and product have been specified and the project has been approved. The purpose of this phase is to develop a product that is ready to manufacture and information needed to meet the regulatory strategy has been prepared. This includes identifying the product design, production processes, production equipment and tooling, and testing equipment. Using the example of developing a reliable cochlear implant, the design team may decide to include features, such as softly rounded corners and soft silicone rubber encapsulation to prevent tissue trauma, avoiding pockets, crevices or other small spaces in the external surfaces of the implant where bacteria can collect, or using sealed titanium units to withstand wear and tear.

The Launch Readiness Phase aims to transfer the device design into final product specifications. This includes validating processes, ramping up supply chain and obtaining regulatory approval. Quality control is achieved through testing to rule out defects in the final product. In the case of the cochlear implant, after each electrode array has been manufactured, it is put through a number of reliability tests to make sure that it can transmit electrical signals properly before it is ready to be used in surgery. For example, a specialist will use an ohmmeter to check that each of the wires can properly send its sound signal to the cochlea. The clinical team may also decide that, to ensure successful implantation, specialist tools will be provided to help with surgery and for each device that is ordered by a hospital, a second cochlear implant will be shipped as a back-up device. At the end of this phase the product will be launched.

In the Post Launch Phase, Cochlear teams will monitor product performance in the field and take any necessary actions to further support recipients, professionals, or regulators. Throughout this phase, Cochlear may also find more ways to optimise supply chain processes to achieve cost and yield targets, enhance the product with more improvements, or gather information to help inform the development of future products.

Going back to the example of a reliable cochlear implant, evidence will be monitored to test how successful it is in real life. Cochlear is the only hearing implant manufacturer to meet all the reliability reporting requirements of both European and American Standards. Cochlear Quality teams track the cumulative removal percentage (CRP) of all the implants registered worldwide. CRP tells you the cumulative

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Over 440,000 registered Cochlear™ Nucleus® implants worldwide

Number of registered implants - 31 December 2020

DEVICE	ADULTS	CHILDREN	COMBINED
Profile™ Plus	16,210	9,233	25,443
Profile™	51,790	44,036	95,826
CI24RE	80,599	121,425	202,024
CI500	15,388	14,507	29,895
CI24R	18,698	34,851	53,549
CI24M (All)	7,773	11,750	19,523
CI22M	9,670	7,993	17,663

Cumulative Survival Percentage (CSP) data for combined adults and children

YEAR	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33
Profile Plus	99.97	99.97																															
Profile	99.93	99.89	99.85	99.82	99.80	99.79	99.79																										
CI24RE	99.90	99.70	99.70	99.60	99.50	99.50	99.50	99.40	99.40	99.30	99.30	99.20	99.10	99.10	99.00	99.00																	
CI500	96.30	93.90	92.80	92.00	91.30	90.80	90.40	90.00	89.80	89.60	89.50	89.50																					
CI24R	99.70	99.50	99.30	99.10	98.90	98.80	98.60	98.50	98.40	98.30	98.20	98.20	98.10	98.00	97.80	97.70	97.60	97.50	97.40	97.40													
CI24M (All)	99.40	98.90	98.40	98.20	98.00	97.90	97.70	97.60	97.50	97.30	97.20	97.10	97.10	97.00	97.00	96.90	96.80	96.80	96.70	96.60	96.50	96.50	96.50	96.50									
CI22M	99.20	98.60	98.20	97.80	97.50	97.20	96.90	96.70	96.50	96.20	96.00	95.70	95.50	95.20	95.00	94.80	94.70	94.50	94.20	93.90	93.60	93.30	93.10	92.80	92.40	92.00	91.90	91.60	91.30	91.00	90.90	90.80	90.60

Source 19.10 Reliability data for the Cochlear™ Nucleus® CI24RE Series Implant

percentage of functioning implants over a given time period. For example, a CRP of 99% after 16 years means the chance of obtaining continued benefit from the cochlear implant as described for its intended use, is 99% after 16 years. Put another way, the implant is 99% reliable within 16 years. This is the case for Cochlear's most used implant, the Cochlear™ Nucleus® CI24RE Series Implant, which has more than 200,000 registered around the world.

Overcoming resistance to change

Change at Cochlear and COVID-19 response

The global pandemic required Cochlear to adapt the way it delivers its services and support. There was no resistance to change, as it was imperative to ensure supply and fulfilment of the company's mission. During this period, the majority of employees worked remotely and technological solutions to patient care were accelerated. For example, a telehealth patient assessment tool called Remote Check was launched in early 2020. Patients could complete routine hearing tests via a smartphone app.

A second area for change is increased supply chain security. Owing to transport restrictions during the COVID-19 pandemic, inventory management became crucial to ensure enough inputs and components were on hand for manufacturing. Holding more inventory reduces the risk from disrupted supply chains.

Change can be expensive to implement. The financial benefits of these changes are a key driver of change at Cochlear. Approximately AUD$90 million in capital was required for the construction of a new purpose-built manufacturing facility in Chengdu, China. This decision was partly driven by the opportunity to access the emerging market in China. In addition, in 2020 new US headquarters located in Denver, Colorado, were opened, costing US$20 million.

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Global factors

Global sourcing

Cochlear has external suppliers for materials, components and some services. Cochlear's suppliers are mainly high-tech design and component makers. This carries the risk of delays and disruptions in supplies. Certain materials are available from a single source only, and to replace a supplier would require that the new inputs pass regulatory requirements for safety and use in the country of manufacture. Cochlear manufactures its latest-generation products across six sites globally. There is the potential risk of disruption to sales should a manufacturing facility be unable to operate.

To manage this risk, Cochlear monitors its suppliers and identifies potential second-source supply. Where appropriate, lifetime buys, strategic raw materials purchases and supply chain interventions are made.

Economies of scale

Cochlear's new Chengdu facility over time will have the potential to increase global production by 50 per cent.

Scanning and learning

Aside from its collaborations, Cochlear scans developments in medicine and the medical device industry. Medical conferences, such as the annual Audiology Australia Conference, and events for hearing health-care professionals in Europe and America are important sources of information. Online publications such as *MedicalExpo E-Mag*, medical journals and professional research papers are also all important sources of industry trends and developments. The annual Consumer Electronics Show in Las Vegas provides opportunities to scan the environment for innovations that may be relevant to Cochlear.

Research and development

Cochlear is an early adopter of new technology. Cochlear has invested more than A$2 billion since its inception and, on average, invests AUD$190 million each year in research and development. Currently, there are over 100 collaborations with different universities, research institutes and organisations. Cochlear has a number of broad areas of research:

- making the technology smaller, lighter and more seamlessly integrated with peoples' lifestyles
- the ability of digital and telemedicine solutions to expand access to care
- innovation in technology and after-implant services to improve hearing and speech skills.

This last point is important because of the challenge of wide variation in patient experience. More research is needed into the impact of the cause and duration of hearing loss, how the implant is situated in the cochlea, the overall health of the hearing nerve and the individual capability of relearning.

Source 19.11 In 2020, Macquarie University and Cochlear Limited announced the appointment of the Cochlear Chair in Hearing and Health. This co-funded role strengthens the existing partnership between the two organisations, enhancing Macquarie University's position as a global leader in hearing research and practice, and supporting Cochlear's goals to improve understanding of, and support access to, hearing health. The role is intended to develop a leading platform for further impactful public health research in hearing in Australia.

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End-of-chapter tasks

Multiple-choice questions

1 Which of the following is a transforming input for Cochlear?

A Customers
B Manufacturing laboratories
C Surgeons
D Technology

2 Which of the following is the most important performance objective for Cochlear's operations?

A Cost
B Product innovation
C Quality
D Speed

3 What is the purpose of logistics at Cochlear?

A To ensure delivery within 24 hours for replacement parts
B To source material inputs from the global market
C To ensure that quality objectives are achieved
D To ensure the right parts are in the right place at the right time

4 Which quality management strategy does Cochlear use?

A Quality assurance
B Quality reporting
C Feedback quality controls
D Using leading edge technology in its operations strategy

5 What is the most likely reason for Cochlear's decision not to use outsourcing as an operations strategy?

A High financial costs of reorganising operations
B To ensure Cochlear's objectives for quality are achieved
C So that the operations can change to match variation in demand
D To protect Cochlear's brand value

Short-answer questions

1 Explain the role of customers in the operations processes at Cochlear.

2 Analyse the impact of globalisation on Cochlear's operations processes.

Extended-response question

Discuss the impact of the four Vs on the transformation processes used at Cochlear.

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20 Marketing at Cochlear Limited

Chapter objectives

In this chapter, students will:

- investigate the role of marketing at Cochlear
- evaluate the factors influencing the marketing decisions of Cochlear
- examine Cochlear's marketing strategies.

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Video 20.1 Discover the Cochlear™ Slim Modiolar Electrod

20.1 Role of marketing

Since its inception in 1981, Cochlear has been the global leader in implantable hearing solutions. The business's success has been underpinned by an underlying commitment to provide innovative products to patients experiencing hearing loss. To date, Cochlear has provided more than 600 000 implant devices to customers, with its global market share amounting to 60 per cent in 2020.

The marketing function has been successful at promoting the benefits of Cochlear's products and services, having expanded its global reach to over 180 countries, with a direct presence in over 30 countries.

Cochlear had a strong start to the 2020 financial year, experiencing 13 per cent growth in the first half. The launch of the new Cochlear™ Nucleus® Profile Plus Series implant in 2020 was well received, driving market share gains in many countries.

Strategic role of marketing goods and services

Profit maximisation is a key objective for all businesses. Successful organisations aim to generate profit to provide shareholders with steady returns. This is achieved by understanding the needs of the target market and developing cost-effective products that increase customer satisfaction. It is critical for businesses to continually investigate the market in which they operate so that the most appropriate strategies can be implemented. Strategic marketing enables a business to develop a point of difference from its main competitors.

Much of Cochlear's success can be attributed to the company's innovative marketing department. Cochlear has a long track record of delivering sales revenue growth. From 2013 to 2019, the business experienced a year-on-year increase in sales. This was underpinned by continual increase in the sale of cochlear implants as well as the growing income stream from the services side of the business. In 2020, the services business accounted for 29 per cent of all sales revenue generated by Cochlear, indicating potential for future growth. As for most businesses, the impact of the COVID-19 pandemic hindered sales and profit levels in 2020; however, Cochlear is confident about the opportunity to grow in future.

Interdependence with other key business functions

It is essential that the marketing function works in collaboration with the operations, finance and human resource departments to ensure that the correct strategies are developed and implemented.

Operations

There is a strong interdependence between marketing and operations, which is reflected by Cochlear's ongoing commitment to product and service innovation. The marketing function must

Source 20.1 Cochlear is the market leader in the implantable hearing solutions market.

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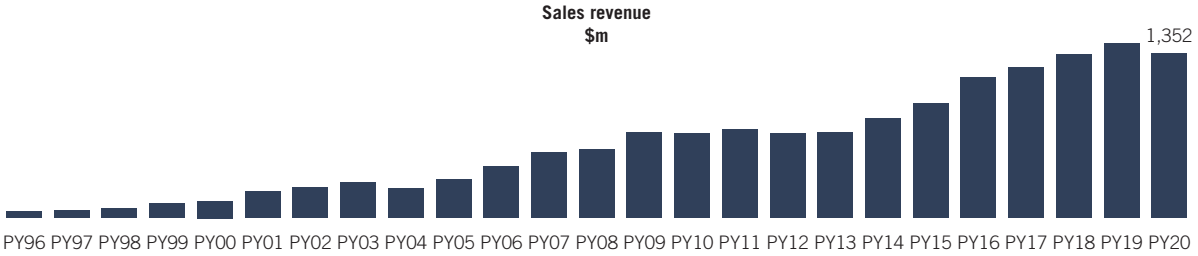

Source 20.2 Cochlear has achieved sustainable sales growth over many years.

work with operations to ensure that the hearing implants created suit the needs of the various target markets that Cochlear directs its attention towards.

Finance

Cochlear's continued success has been a result of strong product and services innovation. In the 2020 financial year, the business invested $185 million towards research and development (R&D), which equated to 14 per cent of its total sales revenue. Marketing has committed to developing new products such as the Cochlear™ Nucleus® Kanso® 2 Sound Processor and Cochlear™ Osia® System, which provides users direct connectivity with compatible smartphone devices. In recent times, the marketing team has introduced various campaigns to increase customer awareness of its products in a bid to maximise sales. Funding provided by the finance function is crucial for the marketing department to implement its various product and promotion strategies.

Human resources

Cochlear has a diverse global workforce that is integral in transforming the lives of people with hearing loss. Over 4000 employees are focused on delivering excellence in order to support cochlear and acoustic implant recipients. Each employee contributes to ensuring that Cochlear's mission is achieved.

Production, selling and marketing approaches

Cochlear has made effective use of the marketing approach by demonstrating a commitment to augment and refine its product and service offering to suit the evolving needs of its end users. The business has a dedicated market insights team that collects market research from key stakeholders, including consumers and health practitioners. These insights are used to inform Cochlear's product development and promotional strategies. Cochlear has enhanced the customer experience by engaging in customer life-cycle marketing. This concept of relationship marketing allows Cochlear to understand and respond to the needs of its customers across the life cycle, and the challenges in helping people hear.

Types of markets

Cochlear operates in several markets. Primarily, the business features in both the intermediate and consumer markets, which allows Cochlear to extend its reach and broaden the network of customers to whom the products are sold and distributed.

Intermediate

Cochlear has been actively building global networks with many health-care professionals, governments and private insurance companies to address the unmet need for cochlear and acoustic implants. This business-to-business (B2B) relationship is crucial to increasing awareness of the Cochlear brand and alerting patients to the solutions available to them. Historically, many hearing aid audiologists have not referred patients on for cochlear implant assessments. In many instances, the hearing specialists were unaware of the cochlear implant technology or how to refer patients for an assessment. To counter this, in America Cochlear has invested heavily in establishing the Cochlear Provider Network, a referral system that

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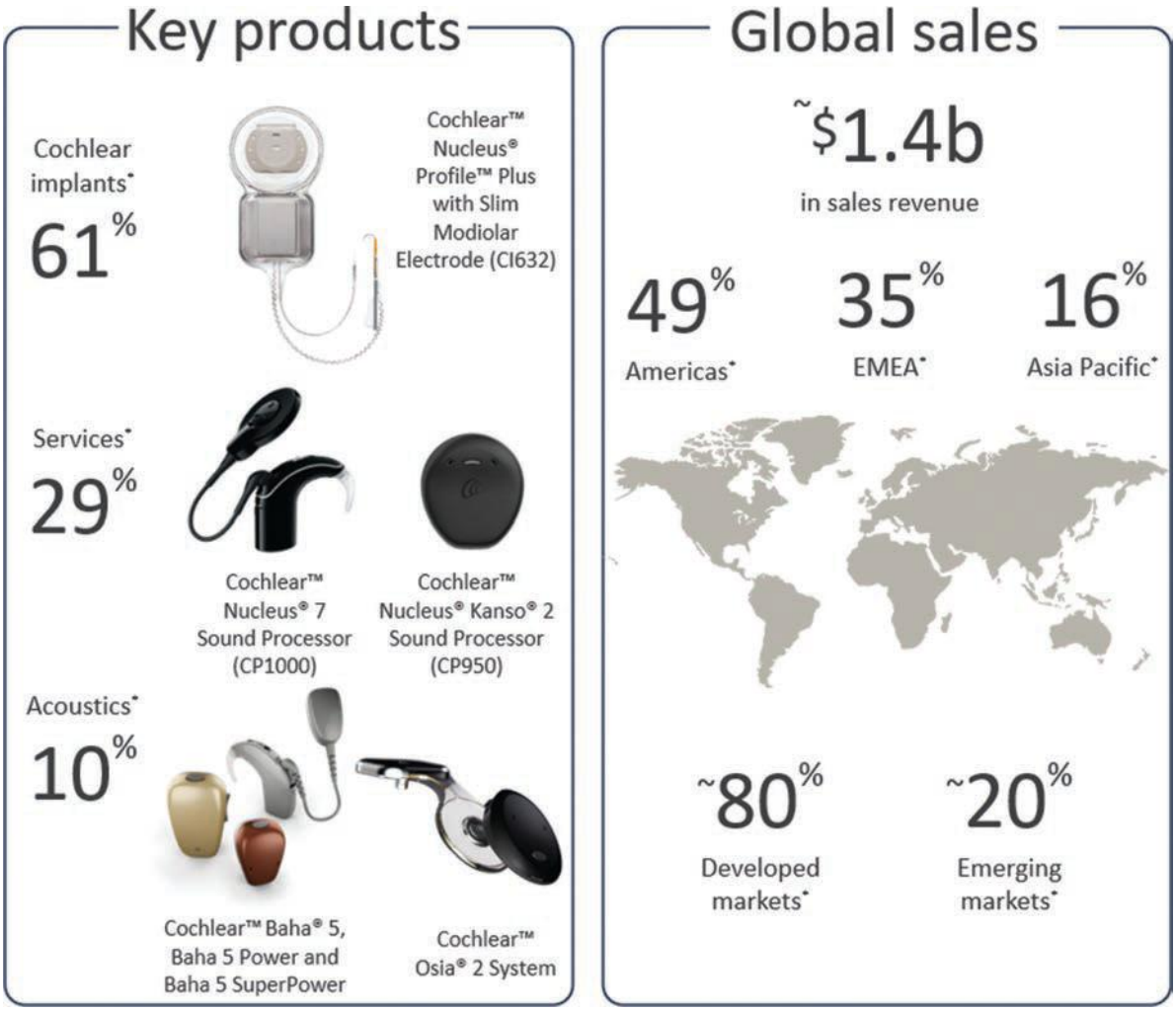

Source 20.3 Key to Cochlear's global success has been its commitment to product innovation. Figure as at 30 June 2020.

provides education to audiologists and links them with surgeons that can better advise patients of possible treatments. Cochlear's initiative has been successful in developing the intermediate market, with over 400 Cochlear providers in the US today.

Consumer

As the consumers of cochlear implants have highly specific needs, Cochlear operates primarily in the niche market. Since 2011, the business has utilised business-to-consumer (B2C) marketing to build awareness of cochlear implants and their indications. This has proved to be an effective way of identifying implant candidates who are seeking alternatives when hearing aids are not enough. Operating in the consumer market allows Cochlear to provide candidates of its implant technologies with a clear pathway to care before and after surgery. This method has been highly effective among the over-65-year-old market.

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20.2 Influences on marketing

Factors influencing consumer choice

Motivation

Cochlear implants support people with severe to profound hearing loss. The key motivation for recipients of a cochlear implant is the improvement of their hearing. Hence, Cochlear's unrivalled commitment to product innovation adds to the perception of the company held by recipients around the globe. The advancements in technology have improved the customer experience and helped Cochlear to position itself as a leader in the hearing implant market.

Learning

Cochlear understands that learning plays a key role in influencing customer choice. Learning refers to the process of acquiring new knowledge or preferences regarding a good or service. The decision to undergo cochlear implant surgery can often be daunting for a patient, both physically and financially. Therefore, the business invests significantly in educating patients and health practitioners about the benefits associated with Cochlear's product range. This is done through initial consultations with clinicians and the Cochlear Provider Network.

Economic

There are significant costs associated with the surgery to implant a cochlear device. In developed markets, the upfront and ongoing costs of cochlear implants is either fully, or substantially, covered by government or private health insurance. In other markets, before committing, patients must also consider the ongoing costs to service and update the technology throughout the lifetime of the implant. Economic downturns could create financial uncertainty, impacting negatively on customer choice as many patients make the decision to defer surgery. Furthermore, many governments imposed restrictions on elective surgeries to reduce the strain on health-care systems, which limited options available to potential implant recipients. During COVID-19 pandemic lockdowns, surgery might have been postponed due to health-care providers deferring elective surgeries to prioritise hospital capacity.

Government

Cochlear operates in a highly regulated industry. The Australian Government ensures the safety of all implant recipients by legislating certain requirements for all medical devices sold and distributed. Medical devices and implants are subject to strict regulations that cover data security, standards and performance requirements. The Therapeutic Goods Administration is the government body responsible for administering the Australian Regulatory Guidelines for Medical Devices that Cochlear must abide by.

Cochlear also operates in an ever-evolving industry that has substantial intellectual property, patents, designs and trademark protection. New product designs may be patented and registered with various patent offices around the world to protect Cochlear's competitive advantage and avoid imitation from its rivals.

Consumer laws

The Australian Consumer Law requires all businesses to uphold the implied conditions of a transaction. The *Competition and Consumer Act 2010* (Cth) may provide remedies for consumers where a good or service is not fit for purpose or does not fulfil its intended purpose. In Cochlear's case, under the terms of its warranty, consumers might be entitled to a repair, replacement or refund should certain circumstances arise. Cochlear is responsible for the design, testing, manufacture, post-market monitoring and, in some situations, repair of its products.

Ethical aspects of marketing

There are strict industry codes of conduct regarding product marketing in the health-care industry. In Australia, the Therapeutic Goods Advertising Code governs how medical devices can be marketed to consumers. Cochlear's Global Code of Conduct outlines that Cochlear representatives must conduct business lawfully, ethically and responsibly. The company's quality and safety systems function to help ensure the business is not marketing a product that may damage the health of its implant recipients. Cochlear's ethical standards are demonstrated in the business's Global Code of Conduct and the Environmental, Social and Governance Report.

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20.3 Marketing process

Situational analysis

Product life cycle

Globally, Cochlear is currently in the growth phase of the product life cycle. This is categorised by the significant, unmet and addressable clinical need for implantable hearing solutions and less than 5 per cent market penetration. The marketing function of Cochlear is continually investigating ways to reinvigorate its marketing plan to ensure it maintains a competitive advantage over its rivals. Cochlear has demonstrated a clear commitment to investing in research and development to drive its future product innovation.

SWOT analysis

The SWOT analysis that follows provides an overview of the internal and external factors impacting on Cochlear's business.

Strengths

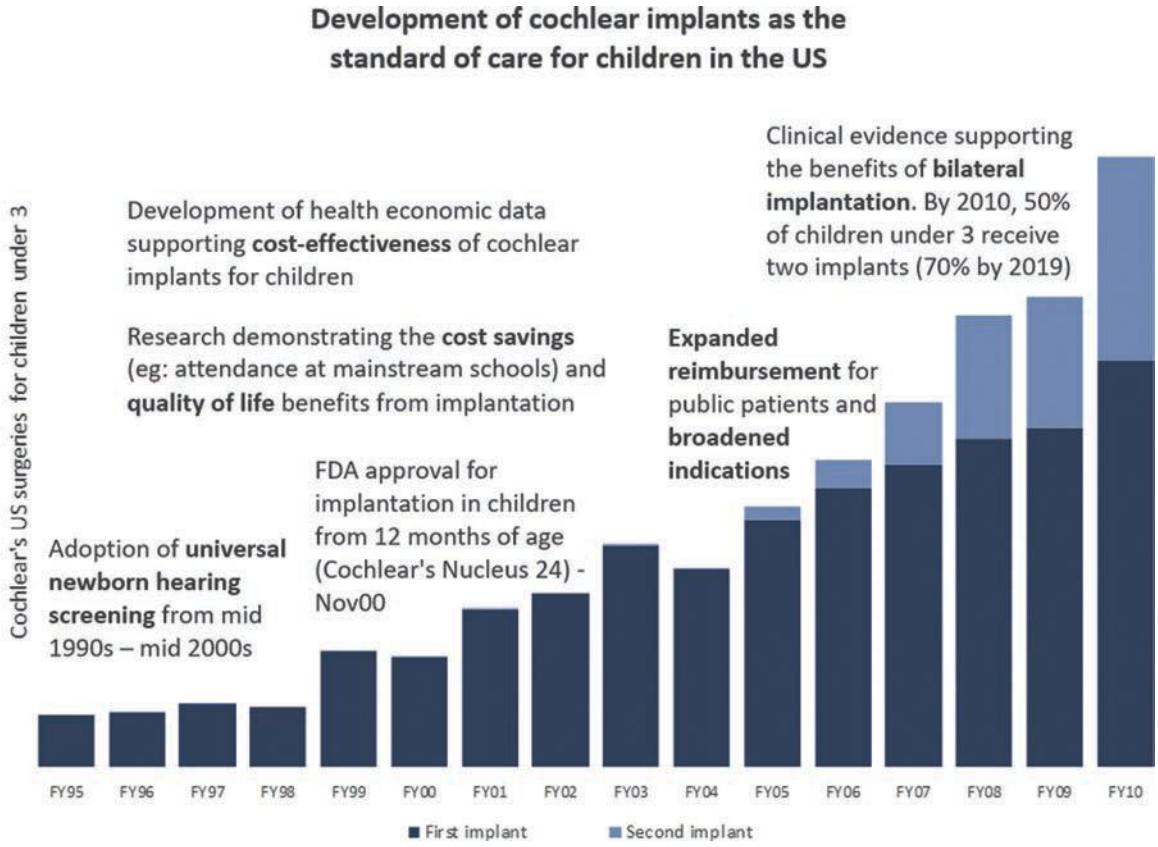
- Market leader fostered by strong brand awareness.
- Strong cash flow position to help fund future growth, R&D.
- Commitment to product innovation, including new sound processor upgrades.

Weaknesses

- Heavy reliance on health practitioners and audiologists to refer patients experiencing hearing loss towards Cochlear products.
- Low awareness of cochlear implants by both hearing aid audiologists and consumers.

Opportunities

- Low awareness of cochlear implants by both hearing aid audiologists and consumers.
- Growing revenue streams from the services function of the business.
- Significant, unmet global need for implantable solutions, especially in developing regions.
- By 2050, the World Health Organization estimates that approximately 2.5 billion people will experience hearing loss.



Source 20.4 The development of cochlear implants as the standard of care for children in the United States

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Threats

- Economic downturn or health pandemic, which may restrict patients' access to implant surgery.
- The risk of medical, biological and/or technological advancement by other companies where alternative products or treatments are developed.
- Lack of government funding and reimbursement for surgery (Medicare).

Market research

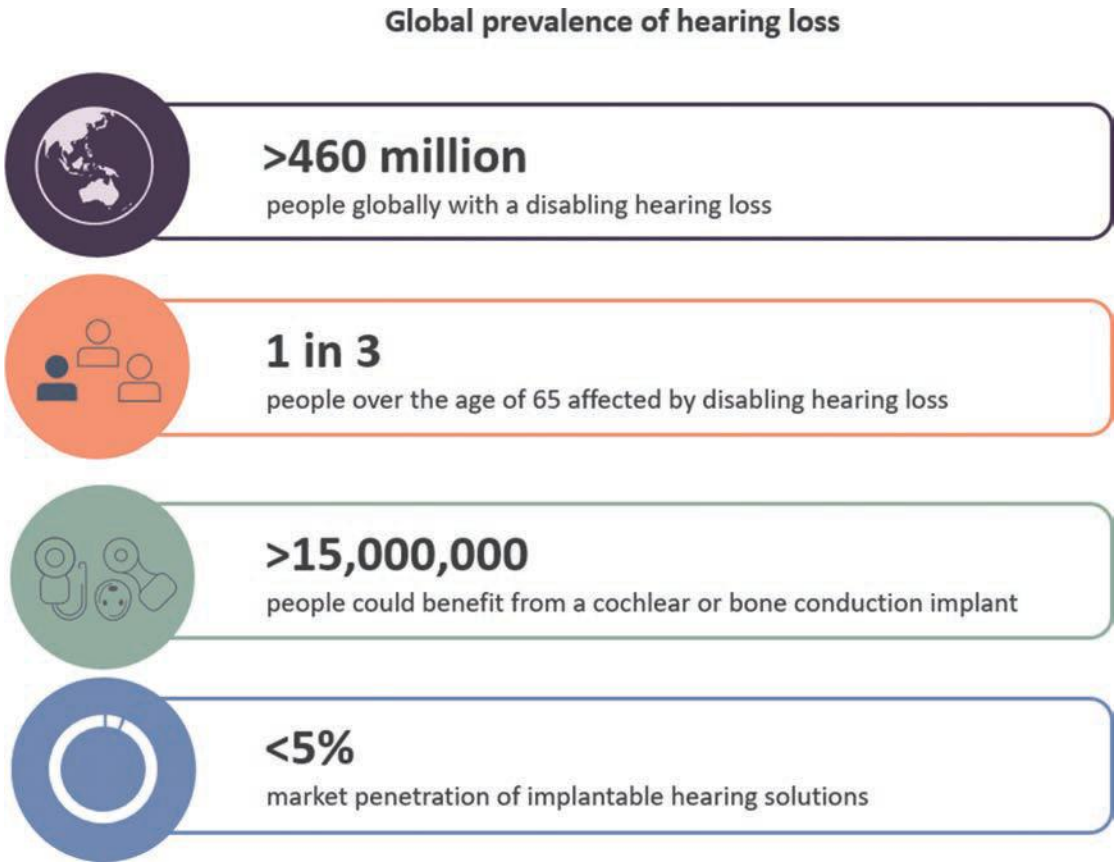
Extensive market research ensures that Cochlear gains important information regarding its customers. This helps to inform the business's marketing strategies, including future product modifications. Cochlear employs a dedicated market insights team that manages all market research initiatives with the key stakeholders of the business. This team engages in primary research by gathering quantitative and qualitative data in the form of surveys, interviews and focus groups. Furthermore, Cochlear uses field teams that work directly with health practitioners to gain feedback on the patient's experience.

Cochlear also uses observational data when trialling its new products. The dedicated clinical team oversees all clinical trials using volunteers to test its investigational devices. The results from these tests are used to evaluate the performance of the products before and after approval, and inform the operations team of any required changes.

At a global level, Cochlear uses market research to inform future project developments. As medical devices are complex technologies, Cochlear plans new product designs sometimes 10 years in advance. Therefore, market research gathered today from focus groups or advisory boards may inform what products the company launches in 2031 and beyond.

Establishing market objectives

Cochlear is committed to retaining its market leadership in the global implantable hearing solutions market. To achieve this, the business has developed three key strategic priorities, which are outlined in its 2020 Strategy Overview.



Source 20.5 The unmet need for hearing devices, especially in developing countries, provides opportunity for Cochlear. Figure as at 30 June 2020.

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The key priorities for Cochlear are:

- to retain market share leadership, including through a commitment to innovation

- to grow the hearing implant market, such as adults and children in developed markets and children in emerging markets (e.g. South-East Asia)

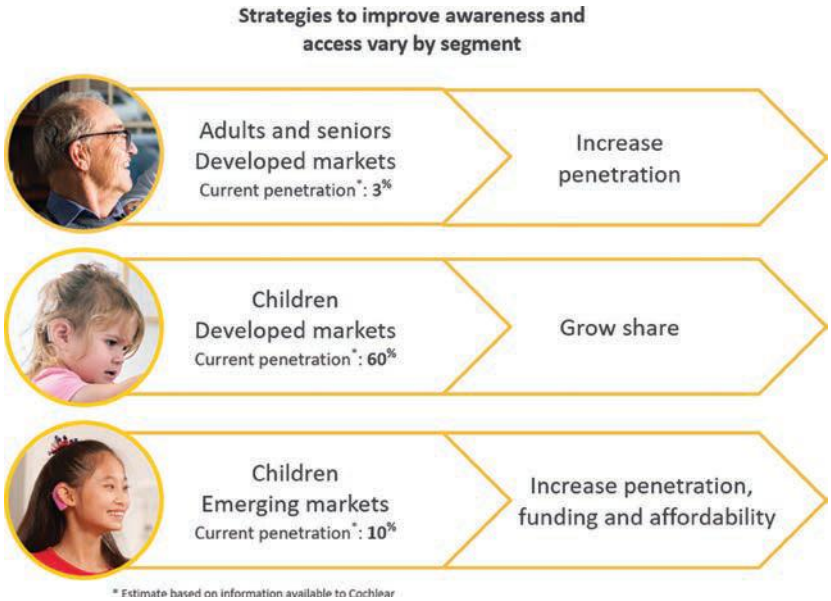
- To deliver consistent revenue and earnings growth over time, Cochlear balances spending to grow the market with investment to maintain our competitive position while ensuring it has an agile, efficient and environmentally responsible business processes to support growth ambitions.

Source 20.6 Three key strategic priorities

Identifying target markets

Cochlear uses market research to help identify its primary and secondary target markets. Demand for cochlear implants is increasingly being driven by older adults in developed markets and by children across emerging markets. Having a greater understanding of the characteristics of each segment allows Cochlear to amend its marketing strategies according to need.

Specific strategies have been developed for each of the target markets identified previously. These strategies are centred around improving the awareness and access of the segments to the Cochlear products and services.



Source 20.7 Cochlear's key target markets and the strategies used to penetrate the market. Figure as at 30 June 2020

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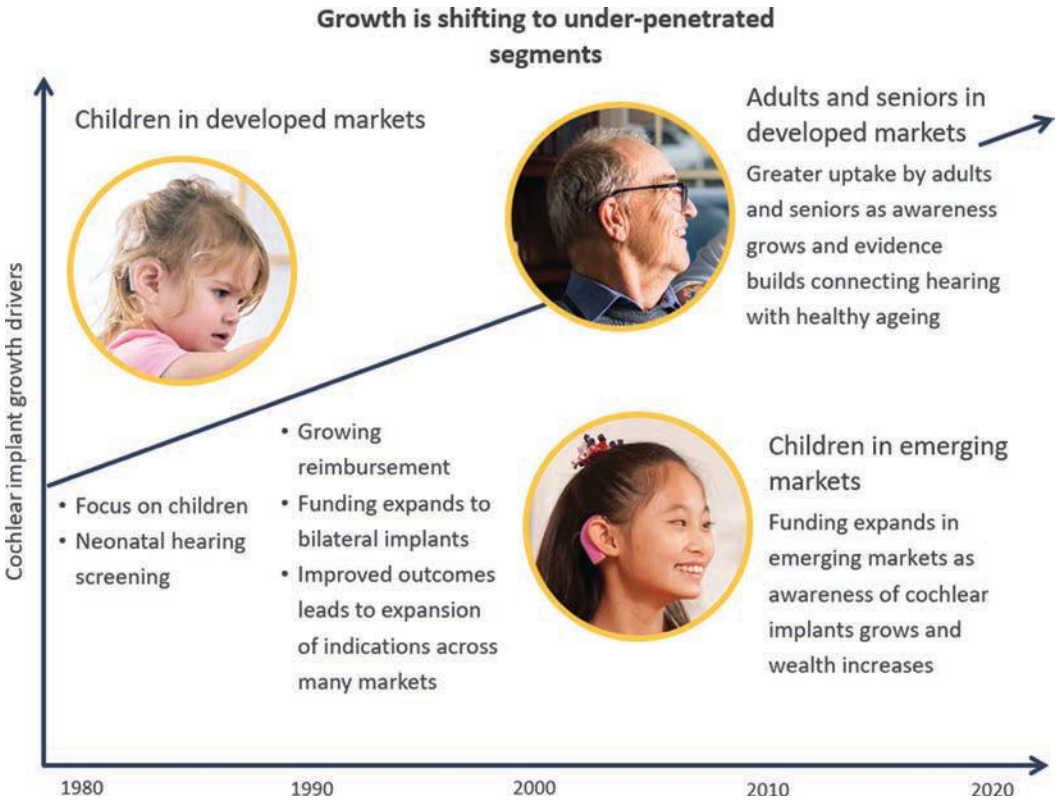

Source 20.8 Cochlear's marketing strategies are moving towards under-penetrated markets.

20.4 Marketing strategies

Developing marketing strategies

Cochlear uses an integrated marketing mix to deliver value to its customers. All of the 7Ps (product, price, promotion, place, people, process, physical evidence) are used together to ensure that the marketing objectives are achieved. Throughout its history, Cochlear has amended its marketing strategies to ensure that the needs of its customers are continuously being met. As the market segment has changed, so too have the promotional activities undertaken by the business. In the last 10 years, Cochlear has focused more of its resources on communicating directly with the end user. This has involved developing a greater social media presence on all major platforms, aimed at educating potential customers about the benefits of using a cochlear implant. This has proved an effective way of linking candidates to surgeons, clinicians and audiologists.

Promotional strategies are also used successfully to inform candidates and health practitioners of the improvements made to the product and the operations process.

Implementation, monitoring and controlling

Global, regional and national marketing teams of Cochlear evaluate their strategies and campaigns at various intervals, depending on the type of activity being undertaken. For instance, the Australian marketing team may evaluate the effectiveness of a social media awareness campaign on a daily, weekly or monthly basis, whereas a global product launch campaign may be evaluated formally every six, 12 or 24 months.

When monitoring the success of promotional campaigns, the marketing team typically looks at key performance indicators such as the number of impressions, shares and likes on its social media platforms. When launching new products, the team usually monitors the volume of unit sales made and the results from customer satisfaction surveys. Using quantitative data helps to compare the actual results with the planned marketing objectives.

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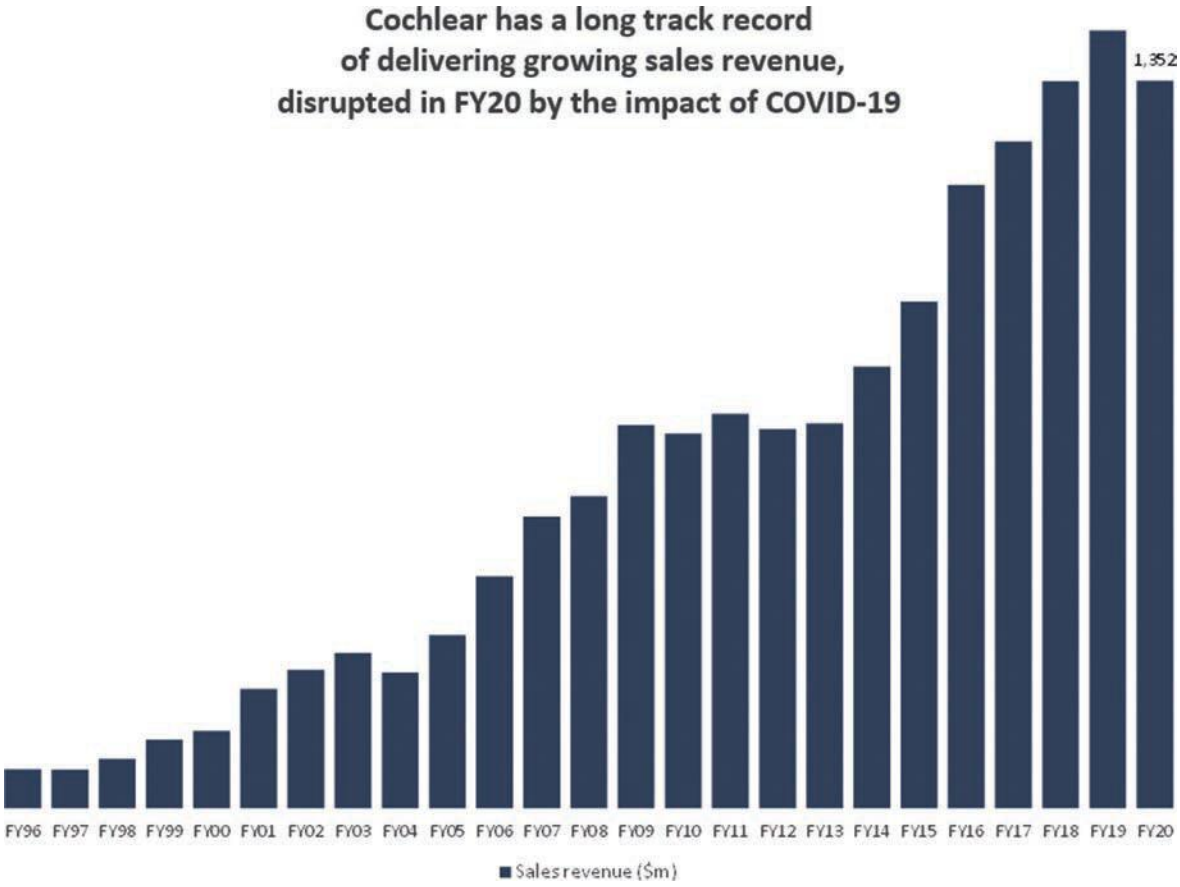

Source 20.9 Cochlear has been effective at meeting its marketing objectives, as outlined by the steady increase in sales.

Market segmentation

Cochlear primarily segments its markets using a demographic and geographic segmentation approach. Typically, customer segments are broken down by age and location. The marketing team at Cochlear refers to its segments as adults over 65 years old in developed markets, children in developed markets, or children in emerging markets. Segmenting the market based on geography assists the business in differentiating its product to specific countries.

Product/service differentiation and positioning

Cochlear has been able to position itself as a brand that provides innovative and high-quality hearing solutions. With its sustained growth in cochlear recipients, the business has continued to differentiate its offering by investing heavily in the strengthening of its service capability. This has been designed to provide additional customer service and support the lifetime relationship with recipients.

Products

Cochlear is a well-recognised and established brand in the implantable hearing solutions marketplace. Despite this, the business continually seeks to update its product range to maintain its market-leading position.

Goods

Cochlear has a global innovation network with over 350 research and development employees dedicated to developing new products. Product and service R&D spans across implants and sound processors, sound coding, clinical and surgical tools. Over the past few years, Cochlear has launched the following market-leading products with much success:

- Cochlear Nucleus Profile Plus Series cochlear implant, with the world's thinnest full-length perimodiolar electrode[1,2]

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- Cochlear Nucleus 7 Sound Processor, the industry's smallest and lightest behind-the-ear cochlear implant sound processor, enabling recipients to connect to compatible Apple and Android devices
- Cochlear Nucleus Kanso 2 Sound Processor, the world's smallest off-the-ear cochlear implant sound processor[3].

The ongoing commitment to developing new solutions has become synonymous with the Cochlear brand. The business is able to leverage its standing within the market to great effect, using its branding and promotional activities to communicate its value to its major target markets.

Services

The services function of the business has been a key area of strength in recent years. Cochlear has invested in expanding its post-sales service department to help ensure that customers are satisfied for the lifetime of their cochlear implant. The services business provides sound processor upgrades including, where available, backward compatibility of sound processors with prior generation implants. This also provides Cochlear with a regular and ongoing revenue stream, which is anticipated to assist in the future growth of the business.

Video 20.2 Discover the Cochlear™ Nucleus® Kanso® 2 Sound Processor

Source 20.10 The large product mix allows Cochlear to access various markets; Figure as at 30 June 2019.

1. Cochlear Ltd. EA32 Electrode Insertion Safety and Performance Study, 2015 - Windchill 415680
2. Cochlear Ltd. EMEA CI532 FEP 2015 - Windchill D806144
3. Cochlear Ltd. D1190805 Sound Processor Size Comparison. 2020; March

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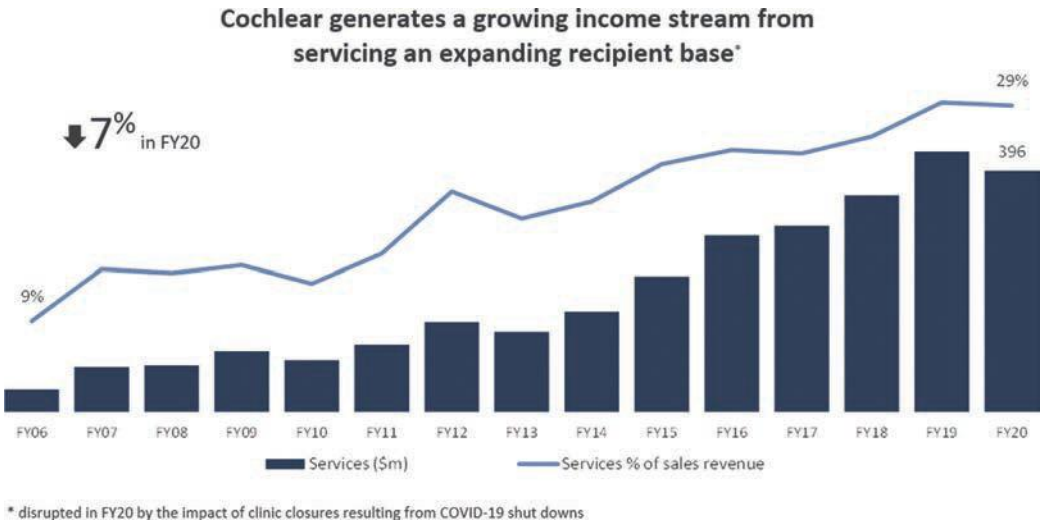


Source 20.11 The aftercare and service function has provided a steady income stream for Cochlear.

Price

Cochlear's pricing strategy reflects the high degree of differentiation and product innovation. This approach is justified by the ongoing investment into R&D, which contributes to the overall quality of the products and services offered by Cochlear. As cochlear implant recipients are part of a specialised market with highly specialised needs, a price skimming approach (see chapter 8) allows Cochlear to convey its high quality and reputation.

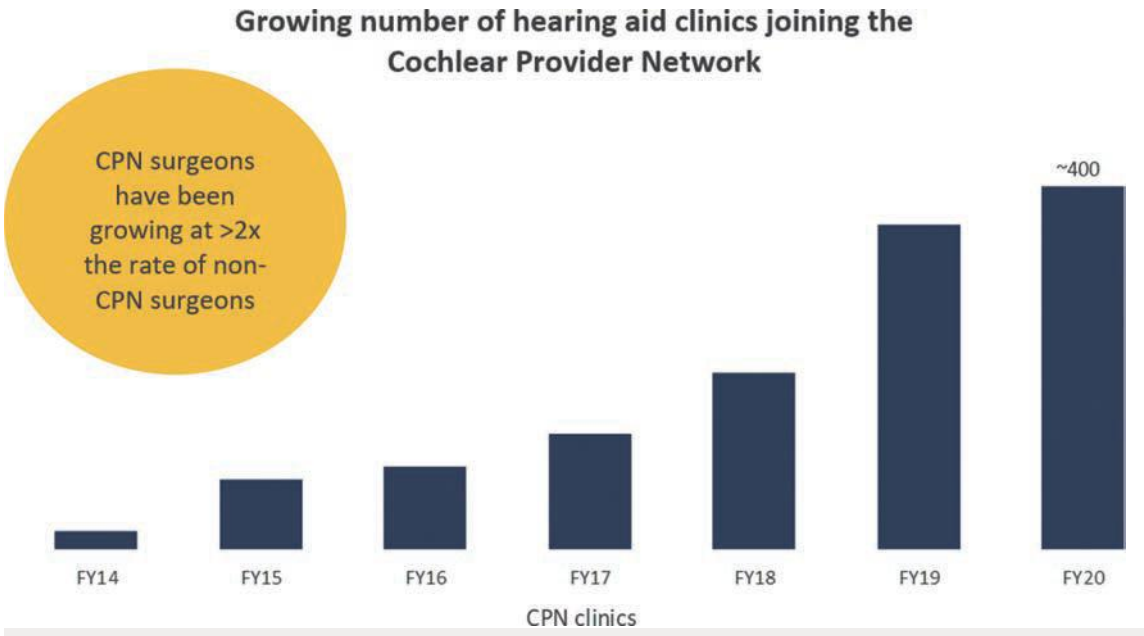
Cochlear also offers a broad portfolio of products to suit the different needs of recipients around the world.

Promotion

Advertising and promotion are a key part of the marketing mix for Cochlear. The business uses different strategies when engaging in business-to-business marketing compared to business-to-consumer marketing.

Business-to-business

Business-to-business promotional campaigns are focused on educating medical practitioners and improving the referral pathway network. Often the promotional activities involve communicating technical information via webinars and trade shows. Cochlear uses personal selling techniques



Source 20.12 Hearing aid clinics are crucial in referring candidates to Cochlear.

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in the form of sales representatives and account managers whose job it is to help convey the benefits to medical practitioners to refer patients for hearing implant assessments.

Business-to-consumer

Business-to-consumer promotional activities focus on improving awareness of the brand and breaking down personal barriers held by potential recipients. Cochlear started actively marketing directly to consumers in 2011 as a way to build greater exposure of cochlear implants. Cochlear Family is a relationship marketing initiative that the business has established to support and guide cochlear implant recipients in their lifetime hearing journey. This allows recipients to connect with other peers in the cochlear implant community through clinics and other subscription programs.

In recent years, Cochlear has used more traditional advertising mediums such as television and cinema advertising to increase brand awareness. In 2017, Cochlear launched the 'Hearing test in disguise' advertising campaign, which was designed to increase awareness of hearing issues. At the conclusion of the advertisement, viewers were asked to take an interactive hearing test that better diagnosed their level of hearing loss. This was designed to direct viewers to their nearest audiologist to seek help.

Place/distribution

Distribution channels

Cochlear uses a selective distribution approach. While the product is available all over Australia and around the globe, recipients of a cochlear implant are confined to those who experience significant hearing loss. The business operates in both the intermediate and consumer markets, which makes the products more accessible to those requiring a hearing implant solution.

Cochlear is reliant on medical practitioners, private insurance companies and public reimbursement (e.g. Medicare) to help inform potential recipients about its solutions. In 2017, Cochlear acquired audiological software provider Sycle to help drive referrals from hearing aid channels in the US.

Video 20.3 Sue's life full of hearing with her Nucleus® 7 Sound Processors

Source 20.13 Cochlear has engaged in direct-to-consumer marketing in a bid to drive sales.

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Physical distribution issues

As Cochlear products are sold in over 180 countries around the world, optimising transport and warehousing is a key distribution concern for the business. Cochlear ensures that all manufacturing and distribution centres have onsite warehouses, which allows the business to store inventory and dispatch products more quickly.

People, process and physical evidence

People

All employees at Cochlear embody the business's mission. All staff complete a combination of mandatory and optional training programs to help them better understand the needs of the customer.

Process

Hearing implants are medical devices that are fitted for consumers via health-care professionals. Typically, a consumer would undergo initial consultations with a clinician, such as an audiologist. Once the clinician has identified that the consumer may be a candidate for a hearing implant, they will refer them to an ENT (ear, nose and throat) surgeon who will provide additional counselling pre-surgery. The ENT surgeon will insert the internal implant. Sometime after the surgery, the clinician will provide the sound processor, accessories and aftercare.

Hearing implant systems (implants and sound processors) may be delivered to hospitals together, or separately to hospitals and clinics respectively, depending on the unit or bulk orders.

Accessories and aftercare support are available to consumers via clinicians and audiologists or directly to the consumer through online, telephone or mobile applications.

Physical evidence

The cochlear implant and sound processors are the key features of the physical evidence for Cochlear's marketing mix. However, marketing material displayed in surgeon and health practitioner clinics is key to increasing Cochlear's brand awareness.

Source 20.14 Cochlear is a customer-oriented business.

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E-marketing

Cochlear is very active on social media channels, with hundreds of thousands of followers across platforms such as Facebook, Instagram, YouTube, Twitter and LinkedIn. The business customises its digital marketing strategies in countries such as China, where Weibo and WeChat are more accepted.

Recently, Cochlear has engaged in a host of electronic direct mail (eDM) campaigns to reach potential recipients via email. A/B testing email campaigns have been used successfully to increase online traffic to the Cochlear website.

Global marketing

Global branding and standardisation

The business aims to have a consistent brand globally. Cochlear's branding and logos are standardised globally, which ensures there is uniformity in the messages conveyed to the global market. Adopting a standardised branding approach allows Cochlear to exploit economies of scale and reduce overall marketing costs as well as ensure a consistent brand experience.

Customisation

Cochlear uses a customised marketing approach for its products and promotional activities. This is due to regional variations, including cultural and behavioural differences and variability in therapeutic goods regulation. In China, health-care regulations prohibit the use of patient photography in marketing materials. Therefore, Cochlear uses illustrations in all promotional brochures. Furthermore, China's provincial health authorities negotiate bulk supply agreements for hearing implant systems with Cochlear. Private customers will then liaise with the health authorities and customise their device according to their individual need. This means that Cochlear's product must be adaptable and easily customisable.

In the United Kingdom, the marketing mix is slightly customised to suit the local preferences. Research suggests that UK customers respond better to images and photography they can relate to; therefore, real-life images of recipients are used in advertising material. As Facebook is one of the more preferred social media platforms in the United Kingdom, Cochlear devotes more of its marketing budget to this medium.

End-of-chapter tasks

Multiple-choice questions

1 Which factors have contributed to Cochlear's growth in sales?

A Product innovation and low prices
B Increased number of employees and reduced competition
C Changing social preferences and better clinician relationships
D Product innovation and growth of the service component of the business

2 Which of the following are perceived opportunities for Cochlear?

A Unmet needs in the implantable hearing market and future growth in the service component of the business
B Strong cash flow position to help fund future growth in the service component of the business
C Commitment to product innovation and heavy reliance on practitioners to refer patients towards Cochlear
D Unmet needs in the implantable hearing market and strong brand awareness

3 Which of the following represents Cochlear's target markets?

A Children and adults in emerging markets
B Seniors in emerging markets
C Children and adults in developed markets
D Health practitioners

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4 What forms of market research does Cochlear engage in?

A Primary research in the form of industry reports
B Primary research in the form of surveys and focus groups
C Secondary research in the form of observation and testing
D Secondary research in the form of surveys and focus groups

5 How does Cochlear engage with the intermediate market?

A Social media marketing
B Electronic direct messaging
C Cochlear Provider Network referral system
D Business-to-consumer marketing referrals

Short-answer questions

1 Outline how Cochlear uses a segmentation approach.

2 Explain how Cochlear customises its global marketing mix.

Extended-response question

Evaluate the success of Cochlear's strategies in achieving the strategic role of marketing.

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21 Finance at Cochlear Limited

Chapter objectives

In this chapter, students will:

- investigate the role of financial management at Cochlear
- analyse the influences on financial management at Cochlear
- explain the processes of financial management at Cochlear
- evaluate financial management strategies at Cochlear.

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21.1 Role of financial management

Strategic role of financial management

The 2019 financial year was focused on building greater awareness of cochlear implants, expanding customer access to better solutions for hearing loss and providing a better service to customers. In order to achieve these goals, Cochlear continued to invest in research and development of innovative hearing implant technology and grow its business to provide lifelong support for people worldwide and of all ages who suffer from hearing loss.

Year in review

Strategic priorities	FY19 achievements
Retain market leadership Market-leading technology World-class customer experience	• Increased investment in R&D by 10% to $184m (13% of sales revenue) • Product launches include Nucleus® Profile™ Plus Series cochlear implant, ForwardFocus feature, Nucleus 7 Android audio streaming capability, Cochlear™ Research Platform ECochG surgical tool and Remote Check (pilot roll-out stage) • Increased organisational capability through skills and leadership development • Commenced clinical feasibility study for the totally implantable cochlear implant • Investments in customer experience and customer engagement including rolling out website refresh in the US and expansion of Cochlear Family • Strengthened the technology and commercial alliance with GN Hearing
Grow the hearing implant market Awareness Market access Clinical evidence	• 7% growth in sales revenue • Expansion of direct-to-consumer marketing and hearing aid channel referral programs • Investment in activities to support cochlear implants becoming the standard of care for adults and seniors with severe to profound hearing loss • Expanded market access capabilities globally • Cost effectiveness data supporting continued funding of cochlear implantation in adults • Positive results from clinical studies demonstrating the effectiveness of cochlear implants over hearing aids
Deliver consistent revenue and earnings growth Invest to grow Operational improvement Strong financial position	• Realised operational improvements and efficiencies in supply chain, customer service, and transactional areas • Cash flows reinvested into market growth activities, construction of China manufacturing facility, IT infrastructure, emerging market distributor acquisitions and investment in Nyxoah • Operational improvements drive gross margin expansion, providing additional funds for investment • Maintained strong balance sheet position with net debt increasing modestly to $103m • Increased dividends by 10%, achieving a 69% payout • Delivered net profit of $266m (excluding innovation fund revaluation gains), within guidance range provided • Delivered net profit margin of 18%, in line with target

2 **Cochlear Limited** Annual Report 2019

Source 21.1 Cochlear strategic priorities and achievements, 2019

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In order to do all of this, Cochlear needs to continue to grow. The company reported a net profit after tax of $276.7 million for the financial year (FY) 2019. This was a 13 per cent improvement on the 2018 financial year. Earnings growth, combined with strong cash flow generation, provided a fully franked annual dividend for shareholders of $3.30, an increase of 10 per cent on the previous year. (This included an interim dividend of $1.55 on 16 April 2019 and a final dividend of $1.75 on 14 October 2019.)

The largest proportion of Cochlear's revenue comes from the sale of cochlear implants, which represented 58 per cent of total sales revenue in 2019. Services accounted for 30 per cent of sales revenue (an increase of 20 per cent from 2018), and acoustics 12 per cent of sales revenue.

Source 21.2 Key indicators of Cochlear's financial performance, 2015 to 2019

Financial performance history (FY15 to FY19)

	FY15	FY16	FY17	FY18	FY19
Sales revenue ($ million)	941.9	1 158.1	1 239.7	1 351.4	1 446.1
Earnings before interest and tax (EBIT) ($ million)	206.4	262.6	315.6	348.4	370.1
Net profit after tax (NPAT) ($ million)	145.8	188.9	223.6	245.8	276.7
Total dividend per share ($)	1.90	2.30	2.70	3.00	3.30
Share price as at 30 June ($)	80.15	121.25	155.45	200.17	206.84

Source 21.3 Cochlear sales revenue for 2018 and 2019

	2019 $m	2018 $m	Change % (reported)	Change % (CC)[1]
Cochlear implants (units)	34 083	35 260	↓3%	
Sales revenue				
Cochlear implants	845.1	831.0	↑2%	↓3%
Services (sound processor upgrades and other)	427.2	355.2	↑20%	↑14%
Acoustics (bone conduction and acoustic implants)	173.8	165.2	↑5%	↓1%
Total sales revenue	**1 446.1**	**1 351.4**	**↑7%**	**↑2%**

1.Constant currency (CC) removes the impact of exchange rate movements and foreign exchange (FX) contract gains/(losses) to facilitate comparability.

The Americas, which includes the United States, Canada and Latin America, make up 48 per cent of sales revenue and had an overall growth of 6 per cent in 2019. EMEA, made up of Europe, Middle East and Africa, makes up 36 per cent of sales revenue, with a growth of 8 per cent over the year. Asia Pacific, including Australasia and Asia, makes up 16 per cent of sales revenue, with a growth of 6 per cent. Sales have been affected by the economic outlook for many countries.

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Source 21.4 Total sales revenue based on regional areas

Sales revenue	2019 $m	2018 $m	Change % (reported)	Change % (CC)
Americas	688.6	648.5	↑6%	↓1%
EMEA (Europe, Middle East and Africa)	519.2	478.9	↑8%	↑6%
Asia Pacific	238.3	224.0	↑6%	↑2%
Total sales revenue	**1 446.1**	**1 351.4**	**↑7%**	**↑2%**

Objectives of financial management

Profitability

Cochlear reported a net profit of $276.7 million for the 2019 financial year, representing a 13 per cent increase since 2018. This included a revaluation of innovation fund investments. Earnings growth, combined with strong cash flow generation, allowed for a full year dividend of $3.30, fully franked to shareholders. This was an increase of 10 per cent on the previous period. Cochlear's current dividend policy is that 70 per cent of net profits is to be paid out as dividends annually.

Growth

In order to maintain its growth path, Cochlear invests heavily in research and development (R&D). In 2019, Cochlear's R&D investment increased by 10 per cent to $184.4 million (13 per cent of sales revenue). Capital expenditure increased by $42.0 million to $86.6 million, expanding business capabilities, and supporting further development of Cochlear's IT platform to strengthen its digital and security capabilities, and partial construction of the China manufacturing plant. Key areas for growth included:

- growth in services of 20 per cent in the 2019 financial year to 30 per cent of sales revenue
- targeting the adults and seniors market in developed markets (about 3 per cent market penetration); as many people age, they suffer from increased hearing loss
- targeting children in emerging markets (about 10 per cent market penetration).

Cochlear's investment priorities are shown in Source 21.5.

Source 21.5 Cochlear's investment priorities

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Efficiency

From 2018 to 2019, cost of sales declined by 3 per cent to $351.1 million. This was due to:

- manufacturing efficiencies
- improved sound processor reliability
- lower warranty costs
- lower repair expenses resulting from the centralisation of repairs.

Selling, marketing and general expenses increased by 14 per cent to $450.9 million. This increase reflected:

- the continued investment in Cochlear's sales workforce and direct-to-consumer marketing
- growing investment in the long-term market growth activities, including standard of care and market access initiatives.

Liquidity

Operating cash flow increased by $37.9 million to $296.0 million in 2019 and was driven by improved revenue. The free cash flow fell by $44.5 million to $158.2 million due to the increase in capital expenditure and other investments during the year. Cochlear also has backup overdraft arrangements if needed. Cochlear's credit terms are generally 30 days; however, depending on the customer, longer payment periods may be applicable. Government departments and health insurers often have extensive paperwork to be completed and require a longer payment period; this does not mean that they are a greater risk.

Source 21.6 Cochlear's client accounts receivable

Trade receivables	2019 $m	2018 $m
Not past due	239.3	247.3
Past due 1–60 days	42.4	34.8
Past due 61–180 days	16.7	18.0
Past due 181–360 days	6.6	2.6
Past due 361 days and over	8.4	6.3
	313.4	**309.0**

Solvency

The majority of Cochlear's significant debtors are governments, government-supported universities, and clinics or major hospital chains. Credit controls are at a regional level, as credit risk is mainly influenced by political and geographic location. Credit risk through ageing profiles is reported on a monthly basis. Regional management identifies high-risk customers and can place restrictions on future trading, suspend shipments and administer future trading on a prepayment basis. Chief financial officer approval is required to increase a credit limit.

Short-term and long-term growth

For approximately the last 15 years, Cochlear's aim was to penetrate the newborn segment across its developed markets. Currently, cochlear implantation for newborns is the standard of care across most developed markets, with most children receiving cochlear implants at around 12 months of age. As this section of the market is now firmly established, Cochlear's market direction for future growth has moved from the newborn segment to adults in developed markets. Thus, long-term growth is more directly related to adults in developed markets and children in emerging markets.

Additionally, Cochlear's diversified revenue base identifies the growth in the services sector of the business as delivering steady long-term profit growth and consistent growth in revenue for the future.

21.2 Influences on financial management

Internal sources of finance

In 2018, Cochlear had retained earnings of $471.6 million, and by 2019 retained earnings had increased to $ 558.9 million.

External sources of finance

Australian Government grants were received in 2019 worth $1.9 million, and in 2018, $2.3 million.

In terms of equity, Cochlear had a market capitalisation of over $10 billion as at 1 July 2019, representing a share issue of 57 547 820 ordinary

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shares and held by 34 046 individual shareholders. The 20 largest shareholders held 77.42 per cent of the ordinary shares of the company. The shareholders with the largest holdings were:

- HSBC Custody Nominees (Australia) Ltd, with 43.60 per cent
- JP Morgan Nominees Australia Pty Ltd, with 17.48 per cent
- Citicorp Nominees Pty Ltd, with 6.41 per cent
- National Nominees Ltd, with 2.53 per cent.

Share options, performance shares and performance rights exercised in 2019 accounted for an additional 134 937 shares. An employee share plan, in force since 1999, including both short-term and long-term incentive schemes and based on achievement of their performance indicators, included another 5448 shares during 2019. These shares vested with the employee immediately but are non-transferable for a minimum of three years. As at 30 June 2019, there were 57 715 821 ordinary shares issued (compared to 57 547 820 in 2018).

Debt

Cochlear holds several operating leases over its offices, with a rental expense of $29.4 million for 2019 and $27.0 million in 2018. These property expenses are paid over the term of the lease, usually between one and 15 years.

Source 21.7 Debt finance arrangements for Cochlear, 2019 and 2018

	Multi-option bank facilities		Other credit facilities		
	Unsecured non-current bank loan $m	Bank guarantees[1] $m	Unsecured bank overdrafts $m	Unsecured current bank loan $m	Bank guarantees $m
2019					
Utilised at reporting date	179.1	5.3	–	3.3	4.6
Not utilised at reporting date	229.4	9.7	2.9	2.7	5.1
Total facilities	**408.5**	**15.0**	**2.9**	**6.0**	**9.7**
2018					
Utilised at reporting date	145.0	6.5	–	3.7	2.9
Not utilised at reporting date	205.0	8.5	2.7	1.8	1.5
Total facilities	**350.0**	**15.0**	**2.7**	**5.5**	**4.4**

1. Bank guarantees include standby letters of credit.

Note that Cochlear has planned for overdrafts to ensure liquidity; however, in 2018 and 2019 Cochlear did not have to make use of this arrangement.

During the 2019 financial year, Cochlear restructured its bank loan facilities as shown in Source 21.8.

Source 21.8 Cochlear's new 2019 unsecured bank loan facilities

Facility type	1–2 year term $m	2–3 year term $m	3–4 year term $m	> 4 year term $m	Total facilities $m
Committed debt including guarantees	46.2	100.0	100.0	177.3	423.5

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Note that all the facilities shown in Source 21.8 are unsecured and are at variable interest rates, based on the current market interest rates. With regard to the bank loans, Cochlear had a Japanese yen 450 million loan facility, a Swedish kroner 300 million loan facility and a Chinese yuan 300 million loan facility.

Cochlear also uses letters of credit when necessary and had contingent facilities in US dollars, euros, sterling, Indian rupees and New Zealand dollars totalling A$9.7 million (compared to 2018 of A$4.4 million).

Net debt increased from $86.2 million to $103.0 million from June 2018 to June 2019. This was mainly used for capital investment, including the partial completion of the China manufacturing facility and IT infrastructure development.

Influence of government

Cochlear and its wholly owned Australian entities are part of a consolidated group; the group is taxed as a single entity. As Cochlear Limited is an Australian-based company, corporate tax for large businesses is levied in Australia at a rate of 30 per cent on total profits. Thus, in 2019, profit before income tax was $365.6 million and tax paid was $109.7 million. In 2018, profit before income tax was $340.5 million and the tax paid was $102.1 million.

The majority of Cochlear's customers rely on insurers and government health authorities to fund their purchases. There are many countries that have restrictive or capped funding, which limits access to the cochlear implants. Growing awareness of the implications of hearing loss on members of society has put additional pressure on authorities to increase the reimbursement to people in need. Social isolation, depression and inability to work are all potential outcomes of hearing loss. Cochlear works with agencies to outline and clearly establish the health and economic benefits and cost-effectiveness of intervention to improve and restore hearing.

Following health technology assessments conducted in the United Kingdom, the UK Government announced an expansion to its reimbursement criteria for cochlear implants to include candidates with severe hearing loss, doubling the total addressable market and making the implants in adults more cost-effective. This should support growth in the UK market over the coming years. This has also happened in Japan and Taiwan.

Cochlear's long-term research and development program has begun with a clinical feasibility study working towards a totally implantable cochlear implant, which will not be commercially available for years.

Global market influences

Economic outlook

Cochlear sells hearing devices in more than 180 countries worldwide. Around 20% of sales revenue is derived from emerging markets, which are heavily biased to tender sales. However, political and economic uncertainty could negatively impact sales. A small proportion of cochlear implant sales has been affected by recessions and currency devaluations, such as in Turkey and Argentina. However, in the Middle East and Eastern Europe there is strong growth in demand.

Cochlear tries to assess foreign nations and does not have a significant concentration of sales in countries impacted by social, economic and political instability. Cochlear uses global scanning software to assess partners, distributors and suppliers against a checklist on an ongoing basis.

21.3 Processes of financial management

Monitoring and controlling

The following financial reports have been completed in Australian dollars and rounded to the nearest one hundred thousand dollars.

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Cash flow statement

Source 21.9 Cash flow statement for Cochlear Limited for the financial years ending 30 June 2018 and 30 June 2019

Statement of cash flows		
	2019 $m	**2018 $m**
Cash flows from operating activities		
Cash receipts from customers	1448.5	1350.3
Cash paid to suppliers and employees	(1064.7)	(987.8)
Grant and other income received	7.4	4.8
Interest received	0.7	0.6
Interest paid	(5.2)	(8.5)
Income taxes paid	(90.7)	(101.3)
Net cash provided by operating activities	**296.0**	**258.1**
Cash flows from investing activities		
Acquisition of land and buildings	–	(2.6)
Acquisition of leasehold improvements and plant and equipment	(59.9)	(25.8)
Proceeds from sale of non-current assets	–	0.3
Acquisition of IT system costs	(26.7)	(16.2)
Acquisition of other intangible assets	(28.0)	(5.1)
Acquisition of investments	(23.2)	(6.0)
Net cash used in investing activities	**(137.8)**	**(55.4)**
Cash flows from financing activities		
Repayments of borrowings	(405.6)	(321.2)
Proceeds from borrowings	439.1	250.0
Net proceeds/(outlay) from exercise of share options and performance rights	7.4	(0.4)
Dividends paid	(181.8)	(161.1)
Net cash used in financing activities	**(140.9)**	**(232.7)**
Net increase/(decrease) in cash and cash equivalents	**17.3**	**(30.0)**
Cash and cash equivalents, net of overdrafts at 1 July	61.5	89.5
Effect of exchange rate fluctuations on cash held	(0.2)	2.0
Cash and cash equivalents, net of overdrafts at 30 June	**78.6**	**61.5**

Net cash provided by operating activities during the financial year 2019 was $296.0 million and in 2018 it was $258.1 million.

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Income statement

Source 21.10 Income statement for Cochlear Limited for the financial years ending 30 June 2018 and 30 June 2019

Income statement		
	2019 $m	**2018 $m**
Revenue	1426.7	1363.7
Cost of sales	(351.1)	(361.2)
Gross profit	**1075.6**	**1002.5**
Selling, marketing and general expenses	(450.9)	(397.0)
Research and development expenses	(184.4)	(167.7)
Administration expenses	(94.8)	(97.4)
Other income	29.0	10.2
Other expenses	(4.4)	(2.2)
Results from operating activities	**370.1**	**348.4**
Finance income – interest	0.7	0.6
Finance expense – interest	(5.2)	(8.5)
Net finance expense	**(4.5)**	**(7.9)**
Profit before income tax	**365.6**	**340.5**
Income tax expense	(88.9)	(94.7)
Net profit	**276.7**	**245.8**
Basic earnings per share (cents)	479.6	427.3
Diluted earnings per share (cents)	479.5	426.7

The Consolidated Entity has initially applied AASB 9 and AASB 12 at 1 July 2018. Under the transition methods chosen, comparative information is not restated.

Balance sheet

Source 21.11 Balance sheet for Cochlear Limited, as at 30 June 2018 and 30 June 2019

Balance sheet		
	2019 $m	**2018 $m**
Assets		
Cash and cash equivalents	78.6	61.5
Trade and other receivables	319.7	316.7
Forward exchange contracts	2.2	3.7
Inventories	195.4	167.4
Current tax assets	12.2	9.6
Prepayments	26.9	25.3

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Balance sheet		
Total current assets	**635.0**	**584.2**
Other receivables	3.3	2.1
Forward exchange contracts	2.1	0.4
Property, plant and equipment	166.5	128.4
Intangible assets	424.4	345.3
Investments	47.8	15.8
Deferred tax assets	100.1	80.7
Total non-current assets	**744.2**	**572.7**
Total assets	**1 379.2**	**1 156.9**
Liabilities		
Trade and other payables	160.8	140.5
Forward exchange contracts	20.9	13.1
Loans and borrowings	3.3	3.7
Current tax liabilities	34.8	22.1
Employee benefit liabilities	69.5	57.3
Provisions	27.3	24.5
Deferred revenue	42.9	26.5
Total current liabilities	**359.5**	**287.7**
Trade and other payables	42.4	28.1
Forward exchange contracts	7.6	9.2
Loans and borrowings	178.3	144.0
Employee benefit liabilities	13.1	12.0
Provisions	44.2	54.4
Deferred tax liabilities	5.5	8.1
Deferred revenue	2.7	2.6
Total non-current liabilities	**293.8**	**258.4**
Total liabilities	**653.3**	**546.1**
Net assets	**725.9**	**610.8**
Equity		
Share capital	182.3	173.0
Reserves	(15.3)	(33.8)
Retained earnings	558.9	471.6
Total equity	**725.9**	**610.8**

The Consolidated Entity has initially applied AASB 9 and AASB 15 at 1 July 2018. Under the transition methods chosen, comparative information is not restated.

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Financial ratios

- Liquidity

  Current ratio = current assets ÷ current liabilities

  2019: 635.0 million ÷ 359.5 million
  = 1.76 : 1

  2018: 584.2 million ÷ 287.7 million
  = 2.03 : 1

  Net working capital = current assets – current liabilities

  2019: 635.0 million – 359.5 million
  = 275.5 million

  2018: 584.2 million – 287.7 million
  = 296.5 million

- Gearing ratio = total liabilities ÷ total equity as a percentage

  2019: 653.3 ÷ 725.9
  = 0.89 : 1
  = 47% debt compared to 53% equity

  2018: 546.1 ÷ 610.8
  = 0.894 : 1
  = 47% debt compared to 53% equity

- Profitability

  Gross profit ratio = gross profit ÷ sales revenue

  2019: 1075.6 ÷ 1426.1
  = 75.4%

  2018: 1002.5 ÷ 1363.7
  = 73.5%

  Net profit ratio = net profit ÷ sales revenue

  2019: 276.7 ÷ 1426.1
  = 19.4%

  2018: 245.8 ÷ 1363.7
  = 18%

  Return on equity ratio = net profit ÷ total equity

  2019: 276.7 ÷ 725 9
  = 38%

  2018: 245.8 ÷ 610.8
  = 40%

- Efficiency

  Expense ratio = total expenses ÷ sales revenue

  2019: 730.1 ÷ 1426.1
  = 51.2%

  2018: 662.1 ÷ 1363.7
  = 48.5%

  Accounts receivable turnover ratio = sales ÷ accounts receivable

  2019: 1426.1 ÷ (319.7 + 3.3)
  = 4.415 times per year
  = 365 ÷ 4.415
  = 82.5 days on average

  2018: 1363.7 ÷ (316.7 + 2.1)
  = 4.28 times per year
  = 365 ÷ 4.28
  = 85 days on average

Cochlear has been able to fund much of its investing opportunities, dividends, capital expenditure and acquisitions while maintaining conservative gearing levels.

Limitations of financial reports

Normalised earnings

Cochlear reported a net profit of $276.7 million for the 2019 financial year, representing a 13 per cent increase since 2018. This included a revaluation of innovation fund investments.

Capitalising expenses

The cost of an asset included in the financial report is the historical cost provided plus any incidental costs directly attributed to the acquisition. Subsequent costs in relation to replacing a part of the property, plant and equipment are capitalised. This is relevant when the future benefits are expected to accrue from the use of the asset to Cochlear and the cost can be accurately measured.

Debt establishment costs are also capitalised and amortised over the period of the loan. Other costs are included as expenses in the income statement when they occur.

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Valuing assets

Cochlear has revalued its innovation fund. These funds include investments in companies with technologies that may over time enhance Cochlear's core technology. These businesses include Saluda, Nyxoah, Earlens, EpiMinder and Sensorion. The 2019 financial year included $10.8 million in non-cash net gains from the revaluation of the fair value of the innovation fund to $50.9 million.

The financial statements have been prepared on a historical cost basis except for derivative financial instruments and financial investments measured at fair value.

Monetary amounts in the financial reports have (unless otherwise stated) been rounded off to the nearest $100 000 as permitted under the Australian Securities and Investments Commission instrument of 24 March 2016.

Cochlear has included $424.4 million for intangible assets on its 2019 balance sheet. This includes values for goodwill, IT system costs, patents, licences, customer relationships, capitalised development expenditure and intellectual property.

Goodwill is calculated as the difference between the cost of the acquisition and the fair value (market value) of the identified asset that Cochlear acquired. IT system costs include expenditure directly related to the development and implementation of hardware and software of IT systems. All intangible assets are stated at cost less accumulated amortisation and/or impairment costs calculated over the expected life of the asset (for example, IT systems over two to seven years, patents and licences over four to 15 years). These values are reassessed annually.

Ethical issues related to financial reports

Monetary values in foreign currencies have been translated into Australian dollars at the currency rate ruling at the reporting date (in most cases, as at 30 June).

The financial reports have been completed in accordance with the Australian Accounting Standards Board (AASB) and the *Corporations Act 2001* (Cth). They also comply with the International Financial Reporting Standards (IFRS) and the International Accounting Standards Board.

The financial reports have been audited by KPMG and found to satisfy all requirements.

21.4 Financial management strategies

Cash flow management

Cochlear ensures that it has adequate cash flow to support its business.

Working capital management

Control of current assets

Receivables – The majority of Cochlear's customers rely on a level of reimbursement from insurers and government health authorities to fund their purchases. The majority of Cochlear's significant debtors are governments, government-supported universities, and clinics or major hospital chains. Credit controls are at a regional level. Credit risk through ageing profiles is reported on a monthly basis.

Inventory cost is based on the first in, first out principle. This includes costs for cartage inwards or freight. In the case of manufactured inventories and work in progress, cost includes a share of the production overheads for normal operating capacity.

Control of current liabilities

Provisions have been made in the balance sheet for identified future costs, such as long service leave entitlements, annual leave pending and defined benefit plans for 87 employees in two countries in 2019 (2018: 80 employees). These include current and long-standing provisions. In 2019, Cochlear had $71.5 million set aside for provisions.

Bank loans have been renegotiated and are unsecured and carry a variable interest rate based on market rates. Overdrafts have been put in place in case they are needed; however, for 2018 and 2019 they were not utilised.

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Profitability management

Cochlear's gross profit margin has been stable at around 74 per cent to 76 per cent since listing on the Australian Securities Exchange (ASX). In the 2018-19 financial year, Cochlear's capital was used in three main areas:

- working capital – 43 per cent, which is mainly used for inventory
- property, plant and equipment – 20 per cent, being mainly manufacturing equipment in Australia and Sweden
- intangibles and other – 37 per cent, such as goodwill from strategic acquisitions.

Global financial management

Exchange rates

Cochlear is exposed to exchange rate risks. Most of the sales and purchases for Cochlear are completed in Australian dollars, US dollars, Euros, Japanese yen, Sterling, Swedish kroner and Swiss francs. This involves more than 90 per cent of Cochlear's revenues and over 50 per cent of its costs denominated in currencies other than Australian dollars. This means that Cochlear is exposed for any sales and purchases made in any currency other than the Australian dollar. In order to better control its risk exposure, Cochlear utilises forward exchange contracts.

Interest rates

Cochlear has loans in different regions to support its operations in those locations. Cochlear is exposed to interest rate risk in Australia, China, Sweden and Japan. Most of these loans are based on variable interest rates in the local market. Cochlear has a risk-management committee and framework that is responsible for identifying, assessing and appropriately managing these risks. Cochlear enters into interest rate swaps to manage the interest rate risk by using floating versus fixed-rate debt arrangements. It was estimated that if interest rates increased by 1 per cent, this would decrease Cochlear's profit by $0.7 million in 2019 (compared to $1.0 million in 2018).

Hedging

Cochlear uses hedging to control its currency risk. Its risk management aims to manage the impact of short-term fluctuations on its cash flow. Derivative financial instruments, such as forward exchange contracts, are used to hedge exposure to fluctuations in exchange rates in a declining level of cover out to three years. Cochlear generates over 95 per cent of its revenues in foreign currencies but has over 50 per cent of its costs in Australian dollars. The hedging helps provide certainty over cash flows that need to be repatriated to Australia to fund expenses like salaries and wages, research and development, and payments of the dividend.

Cochlear plans for the long term and is fully aware of the importance of its product for the well-being of people of all ages. Its business is based on improving the lot of people who suffer from hearing loss on a worldwide scale. Cochlear constantly looks for improvement in its product and service to support these people in need. In order to achieve this, Cochlear must also satisfy its other stakeholders, including its shareholders. Thus, Cochlear needs to make sure that it runs a viable business with adequate and realistic future planning. It needs to continue to invest in research and innovative technology, develop market growth and educational awareness activities and improve efficiency in order to deliver consistent revenue and earnings growth over the long term.

Source 21.12 Cochlear's use of hedging

	2019 $m	2018 $m
Sale of goods before hedging	1 415.3	1 324.9
Foreign exchange (loss)/gain on hedged sales	(19.4)	12.3
Revenue from sale of goods	**1 395.9**	**1 337.2**
Rendering of services	30.8	26.5
Total revenue	**1 426.7**	**1 363.7**

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Source 21.13 A child with an implant plays during the inauguration of the Cochlear Implant Facility at Chacha Nehru Bal Chikitsalaya, on 4 March 2021 in New Delhi, India

End-of-chapter tasks

Multiple-choice questions

1 Cochlear is:

A a government facility.
B a hospital.
C a public company.
D a not-for-profit organisation.

2 Cochlear's main revenue source is:

A cochlear implants.
B services.
C acoustics.
D hearing tests.

3 How much has Cochlear invested into research and development over its lifetime?

A Between $2 million and $5 million
B More than $2 billion
C More than $5 billion
D Between $5 million and $10 million

4 Cochlear's head office is in:

A Brisbane.
B Sydney.
C New York.
D San Francisco.

5 The majority of Cochlear's sales revenue comes from:

A Asia Pacific.
B Europe, Middle East and Africa.
C Canada, United States and Latin America.
D China and India.

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Short-answer questions

1 Explain Cochlear's strategic priorities for future growth.

2 Explain who Cochlear's main stakeholders are and why Cochlear needs to satisfy them.

Extended-response question

With reference to Cochlear Limited, analyse the sources of funds that Cochlear is using to finance its continued global expansion.

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22 Human resources at Cochlear Limited

Chapter objectives

In this chapter, students will:

- investigate the role of human resource management at Cochlear
- analyse the key influences on human resources at Cochlear
- explain the processes of human resource management at Cochlear.

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22.1 Role of human resource management

Cochlear employs a workforce of more than 4000 people worldwide. Almost 2000 Australians and more than 2000 global employees are at the forefront of assisting and treating individuals with hearing loss.

Cochlear's employees work in a diverse range of fields, with research and development, engineering and manufacturing the core areas of the business. The marketing and finance divisions also play important roles in the success of the business.

In Australia, Cochlear has manufacturing facilities at Macquarie and Lane Cove in NSW and in Newstead, Queensland; world class research operations in Sydney; offices at the Macquarie University campus; and three Cochlear Care Centres in East Melbourne, Dandenong and Geelong, Victoria – a new initiative to help customers get the best hearing outcomes from their implants.

Strategic role of human resources

Cochlear places emphasis on skill and passion in its relationship with its employees. The company website describes working at Cochlear as ' … striving to deliver the best possible hearing outcomes and helping to transform people's lives. It's what makes our work so interesting, challenging, and rewarding. We need people with passion to drive that approach.' This statement reflects the belief that, underlying all of the efforts and skills of Cochlear employees, the importance of achieving the best possible outcomes for its customers is what drives the business forward.

Outsourcing

Cochlear does not outsource its human resources function. The internal division that manages the relationship between the business and employees is called People & Culture. The majority of the workforce is permanent employees.

Having direct operations in more than 30 countries, the People & Culture function must adapt to the many different legal regulations across its diverse workforce. People & Culture teams in each region are tailored to the specific requirements of the environment in which they operate. The People & Culture team includes Centres of Expertise, which focus on talent development, talent recruitment and talent reward. The recruitment, development and reward of highly skilled and engaged employees is important to Cochlear as the nature of its product means services are driven by its employees.

Source 22.1 The Cochlear head office in Sydney

Source 22.2 Cochlear CEO & President, Dig Howitt with special guests at the opening of a Cochlear implantable electronics facility in Newstead, Queensland in 2018.

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22.2 Key influences

Stakeholders

Cochlear has established effective relationships with several stakeholders. These relationships are fundamental to the success of the business.

Employees

With approximately half of the Cochlear workforce employed outside Australia, the People & Culture team needs to not only effectively manage the employment relationship across the divisions of research and development, manufacturing, sales and marketing, and finance, but also across different cultures.

Cochlear promotes a global culture that emphasises lawful, ethical and responsible conduct, as set out in its Global Code of Conduct and as defined by its HEAR behaviours:

- **H**ear the customer
- **E**mbrace change and innovate
- **A**spire to win
- **R**emove boundaries.

Employees are encouraged to prioritise the interests of the customer in all that they do; and by so doing, seek to improve the quality of the customer's life by innovating with the aim to be the best.

Employer associations

Cochlear is a member of a number of different Australia-based employee associations. These include the Business Council of Australia and the Australian Industry Group. In 2020, along with other businesses, Cochlear was asked by the Australian Industry Group to provide feedback on the federal government's JobKeeper initiative designed to assist employees in response to COVID-19.

Unions

Cochlear engages with one of Australia's largest trade unions, the Australian Manufacturing Working Union (AMWU) and consults with this union in the development of an enterprise agreement.

Government organisations

Government organisations play an important role in the human resource function between Cochlear and its employees regarding the governance of wage negotiation and determination, work conditions, health and safety, and discrimination and harassment. Some of these organisations include Fair Work Australia, the Human Rights and Equal Opportunity Commission, and Safe Work NSW.

Economic

Like many businesses, Cochlear was impacted by the significant downturn in economic activity caused by the COVID-19 pandemic. Revenue declined by 60 per cent in April 2020 (compared to April 2019), with sales of cochlear implants (CI) down by 80 per cent. Full financial year revenue declined 6 per cent, with CI unit sales down 7 per cent. The reason for this was the decision by governments around the world to postpone any non-essential surgery, including hearing implant surgeries.

All Cochlear permanent employees were maintained during the pandemic and associated economic downturn. Senior Cochlear executives took at least a 20 per cent temporary reduction in their base salary to ensure all employees of the business could maintain their employment within the organisation while revenue was reduced. In addition, no short-term incentives were paid for the FY20 financial year.

Corporate social responsibility (CSR)

The success of Cochlear's mission depends on its ability to inspire and engage its employees. In 2020, more than 93 per cent of Cochlear employees reported they were proud to work for Cochlear.

Cochlear has developed the Flex@Cochlear program, designed to provide employees with greater flexibility in the way they do their work. Employees can choose to work from home where possible and are offered flexibility in their work hours. If employees are required to be involved in Cochlear's overseas operations, Flex@Cochlear offers permanent employees time in lieu outside traditional working hours.

The Flex@Cochlear program allows employees the flexibility of completing part of their responsibilities working from home – an added benefit to employees with family commitments.

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Source 22.3 Environmental, social, and governance (ESG) focuses and objectives for Cochlear Limited

ESG focus topic	Objectives
Develop our people. Build a diverse and inclusive workplace.	1. Develop leadership capabilities throughout the business. 2. Support internal career opportunities. 3. Embed the global diversity and inclusion strategy across the organisation.
Support the health and wellbeing of our workforce. Reward and engage our talent.	4. Support health and wellbeing. 5. Reduce the incidence and severity of workplace injuries. 6. Improve our high engagement rate and maintain our low turnover rate. 7. Implement fair and competitive pay practices globally.

More than half of Cochlear's employees are female, with the intention by 2023 to have women make up at least 40% of its senior leaders.

In 2018, Cochlear Chief Executive Officer, Dig Howitt, joined the Male Champions of Change (renamed Champions of Change Coalition in 2020), an Australian organisation with the objective of accelerating the participation of women in leadership roles. Cochlear aims to encourage greater participation of women across STEM-based occupations, as females currently occupy more than 51 per cent of roles in Cochlear. Despite female applications for roles being approximately 36%, 48% of all new placements were female in the 2021 financial year.

Cochlear is committed to developing a workplace that reflects the diversity of its customers. The company's Diversity & Inclusion Strategy has five key pillars of focus (Source 22.5).

To encourage greater talent diversity, Cochlear has hosted more than 2000 students annually across Australia to showcase careers within the organisation. This is held in partnership with Australia's major universities across the Science, Technology, Engineering and Mathematics faculties.

In 2019, Cochlear also engaged with Macquarie University to host STEM workshops for Indigenous school students. In conjunction with the university, Cochlear encourages students to seek employment across any of the Cochlear divisions, recognising the company's commitment to diversity within the workforce.

Source 22.4 Dig Howitt, CEO and president of Cochlear Limited

The business also offers a scholarship of up to $15 000 over three years for an Indigenous student choosing to enrol in a Bachelor of Speech and Hearing Sciences course, with industry training at Cochlear and the possibility of future employment.

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Source 22.5 The five key Diversity & Inclusion Pillars

22.3 Processes of human resource management

Talent Acquisition

Video 22.1 Cochlear's award-winning graduate engineering program in Australia.

Cochlear's success is driven by its employees. The majority of recruitment conducted by Cochlear People and Culture is advertised externally. Positions are advertised via Seek and LinkedIn in Australia, reflecting a greater emphasis on technology in the recruitment process. Interviews are conducted by the Cochlear recruitment team and the prospective employee's manager.

Employees are also encouraged to become active participants in the recruitment process. This can be achieved in two ways:

- Applying for positions advertised internally.
- Recommending peers outside the organisation for employment at Cochlear; if the applicant is successful, the Cochlear employee will receive a financial incentive.

Talent Development

The continued development of employees is fundamental to Cochlear's performance. Employees are regularly invited to participate in training programs, with emphasis on skills relevant to specific roles and career progression pathways, or in line with the HEAR behaviours. Employees are encouraged to attend external courses and conferences related to their field, such as science and engineering conferences relevant to research and development staff.

Source 22.6 Cochlear works closely with educational institutions to promote the benefits of careers in science, technology, engineering and mathematics (STEM).

Cochlear has also developed Cochlear Academy, which is an internally facilitated training platform for all employees. The purpose of this platform is to ensure all employees are offered an extensive range of development opportunities.

Cochlear provides employees with over 10 000 courses, including:

- 100 course categories
- 10 000 courses specific to Cochlear
- 9 000 extra courses available through LinkedIn Learning

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Source 22.7 All Cochlear employees receive support during their training.

- a blend of online, video, workshop, classroom, literature and seminar-based learning.

These programs are advertised to Cochlear employees with a simple yet effective growth attitude – Get Upskilled.

Cochlear also makes use of externally facilitated training programs, drawing on the expertise of others outside the organisation to enhance the knowledge and skills of their own employees. The Australian Hearing Hub is an example of this – a state-of-the-art facility based at Macquarie University, Sydney. It has attracted industry leaders to drive innovation and collaboration.

The Australian Hearing Hub members include Hearing Australia, the National Acoustic Laboratories, The Shepherd Centre, Cochlear Limited, NextSense, and Macquarie University Hearing.

The Australian Hearing Hub allows Cochlear employees to engage in training and development programs to gain a greater understanding of the science and mechanics behind hearing loss, equipping staff with a deeper awareness of how to design hearing products that address the natural causes of hearing loss?

Talent Engagement & Reward

By retaining talented employees, Cochlear is able to continue to lead the hearing technologies market. In consultation with its employees, the business has devised a number of initiatives to reward and engage employees. These include:

- the ability to purchase/receive shares in Cochlear, allowing for employees to become shareholders of the company
- providing employees with salary protection insurance to cover illness or disability
- above-award wages through the Cochlear enterprise agreement with its manufacturing employees
- providing market competitive salary and incentives.

My Performance Pathway is a performance program developed by People & Culture to guide employees and their managers on strategies to improve performance in the business. All non-manufacturing employees of Cochlear review their work progress regularly throughout the year with their direct line manager. Each employee receives an annual performance rating of Exceptional, Strong, Developing or Improvement required based on their performance against agreed goals and their behaviours as assessed against the HEAR behaviours. Employees and managers are encouraged to discuss a

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development plan to assist employees with their career progression at Cochlear.

Cochlear also provides short-term and long-term financial incentives to employees and senior management subject to specific performance objectives of the business and individual being achieved.

Financial and non-financial targets are set by the Board, taking into consideration prior year performance, global market conditions, the competitive environment, future prospects and the Board approved budgets. A key part of this performance is measured by business sales, profit, and earnings before interest and tax. Employees are rewarded with cash payments and shares (for senior executives) – the latter rewards successful efforts with part ownership of the business.

Separation

My Performance Pathway is a critical tool used by line managers, supported by People & Culture to continuously review the performance of Cochlear employees. If an employee is reviewed and their efforts are deemed 'Improvement required' on two consecutive occasions, the employee is placed on a formal Performance Improvement Plan. The purpose of this plan is to develop a structured series of tasks and learning designed to support the employee in improving their performance. Should the efforts not improve, People & Culture may work with the line manager as needed to follow the appropriate legal processes to dismiss the employee.

22.4 Strategies in human resource management

Leadership style

People managers at Cochlear apply different leadership styles depending on the nature of the work being performed. Employees involved in the manufacturing of Cochlear products are often led using a more directive approach, meaning line supervisors determine the processes of completing each task. This is because the product must be produced according to various legal and quality regulations and quality standards developed by Cochlear.

Engineers, researchers and sales staff at Cochlear are provided with greater flexibility and autonomy to perform their roles. These employees may be provided with greater scope in how they do their work, where they complete their work, and are granted greater input into the decisions and processes of the business. This is one way in which Cochlear recognises the intellectual contributions made by its employees, and is an example of a participative style of leadership. Underlying this leadership style are the HEAR behaviours. Each year, Cochlear spends over $180 million on research and development, which underlies the significance of those employees involved in this area to the success of the business.

The essence of the HEAR behaviours is to have employees focus on the interests of the customer as the core of all their activities. In addition, they encourage employees to focus on embracing change, innovation, aspiring to win and removing boundaries.

Job design – general or specific tasks

Cochlear embraces the skills and expertise of its employees and provides considerable flexibility in the manner in which employees complete their work. This tends to be more so with the non-manufacturing sector of the business, which relies on the creativity and technical expertise of employees to innovate new products and provide expert advice. The job design of manufacturing tends to be very specific, with line supervisors responsible for the way in which employees complete set tasks for the production of Cochlear devices. This is because the devices must be produced according to various specifications, and therefore manufacturing employees must follow the relevant job design to ensure these specifications are met according to the technical and quality standards expected by the business.

For non-manufacturing roles, the functional manager will work together with a People and Culture business partner to design the scope of new roles as they are recruited. The role will be designed based on a number of factors, including the key deliverables of the role.

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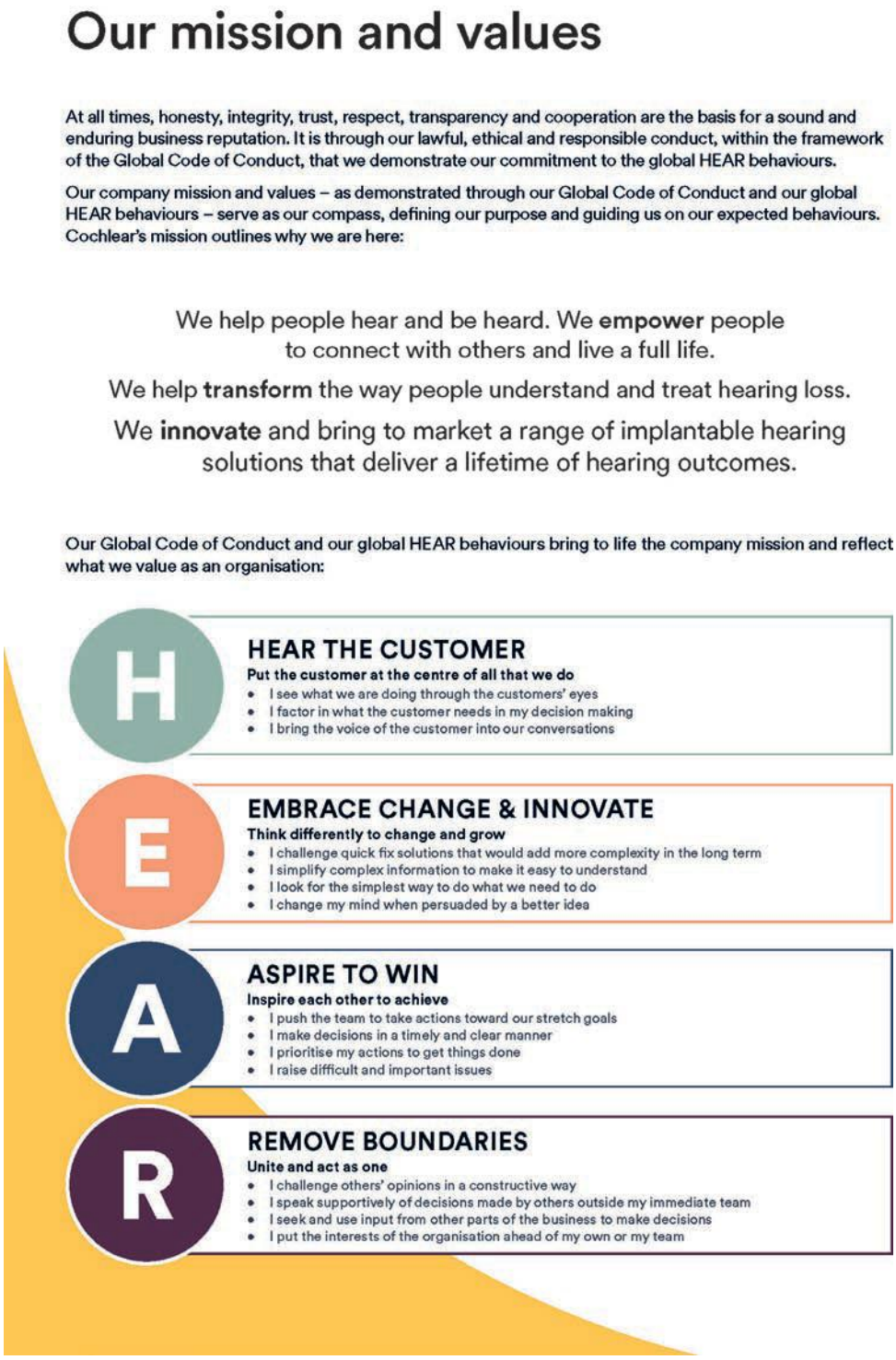

Source 22.8 Cochlear mission and values

Recruitment – internal or external, general or specific skills

The efforts of Cochlear employees are integral to its status as a 'world-renowned, multi-award winning- global company', and its previously mentioned emphasis on external recruitment both within Australia and internationally is designed to seek out and attract the best possible talent.

Cochlear is a business driven by innovation and expertise, hence management seek to recruit external staff to ensure its pool of talent is constantly leading edge amongst industry competitors. However, considerable focus is also given to offering roles to internal candidates as part of their career development.

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Performance management – developmental or administrative

Performance management is a fundamental process that ensures all employees of a business are provided with developmental strategies to improve. My Performance Pathway is a critical tool used by line managers, supported by People & Culture to continuously review the performance of Cochlear employees. Through this process, all non-manufacturing employees are reviewed based on their performance against agreed goals and the HEAR behaviours once a year. Each employee receives an annual rating of Exceptional, Strong, Developing or Improvement required. A rating of Improvement required triggers a process, in the form of a structured series of tasks and learning, designed to improve employee performance.

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

The combination of monetary and non-monetary rewards already discussed, and specifically financial incentives tied to company performance objectives being met, demonstrates Cochlear's use of performance pay in its operations as a key to motivate employees. Employees are recognised through market competitive salaries and a combination of cash and equity incentives, based on skill and performance against goals and the HEAR behaviors.

Cochlear Advantage is another benefit provided to employees. Cochlear, through Reward Gateway Pty Ltd, has negotiated with major Australian retailers up to 10 per cent discounts for employees across everyday transactions from Woolworths, Coles, JB Hi-Fi, David Jones, Country Road and Event Cinemas. Discounts are also available for airfare and hotel bookings.

Non-monetary benefits also play an important role in the business recognising the valued contributions of its employees. Non-manufacturing employees are encouraged to adopt the flexible working practices mentioned earlier, and are provided with much greater autonomy and decision-making in the workplace. These practices include working from home and flexible working hours.

As stated earlier, manufacturing employees of Cochlear are offered less flexibility due to the nature of their role – occurring within the business itself and according to the strict production requirements of the business.

Another key benefit is access to an Employee Assistance Program (EAP) which provides 24/7 support for employees and their families.

A key non-monetary benefit for all Cochlear employees is the prestige of working for such a well-known and highly-regarded business that offers life-changing technology for its users. In 2020, 93 per cent of Cochlear employees said they were proud to tell people they work for Cochlear.

Global – costs, skills, supply

More than two-thirds of Cochlear employees are employed across its global divisions in 35 different countries, ranging from Sweden, to the United Kingdom, China and the United States. While much of the design and engineering of the Cochlear™ hearing implant is based in Sydney, Australia, the business model has extended overseas to expand production to meet global needs.

In addition to its global supplier base, Cochlear uses expertise from around the world to design and manufacture its products.

- Australia: product design, development and manufacture of the Cochlear implant systems is carried out across two sites in Sydney and one in Brisbane.
- Kuala Lumpur, Malaysia: Cochlear's Global Repair Centre is responsible for repairs and assembly of some Nucleus Sound Processors.
- Gothenburg, Sweden: development of bone conduction solutions.
- Boulder, US: support for Cochlear's active middle-ear implants.
- Chengdu, China: At a cost of AUD$50 million, Cochlear has built a new facility, which aims to increase global Cochlear implant production by around 50 per cent. Cochlear expanded its manufacturing operations to the city of Chengdu, China, for the manufacture of Cochlear implants and sound processors.

The purpose of expanding manufacturing into China was to increase supply to meet global demand in China and other neighbouring countries.

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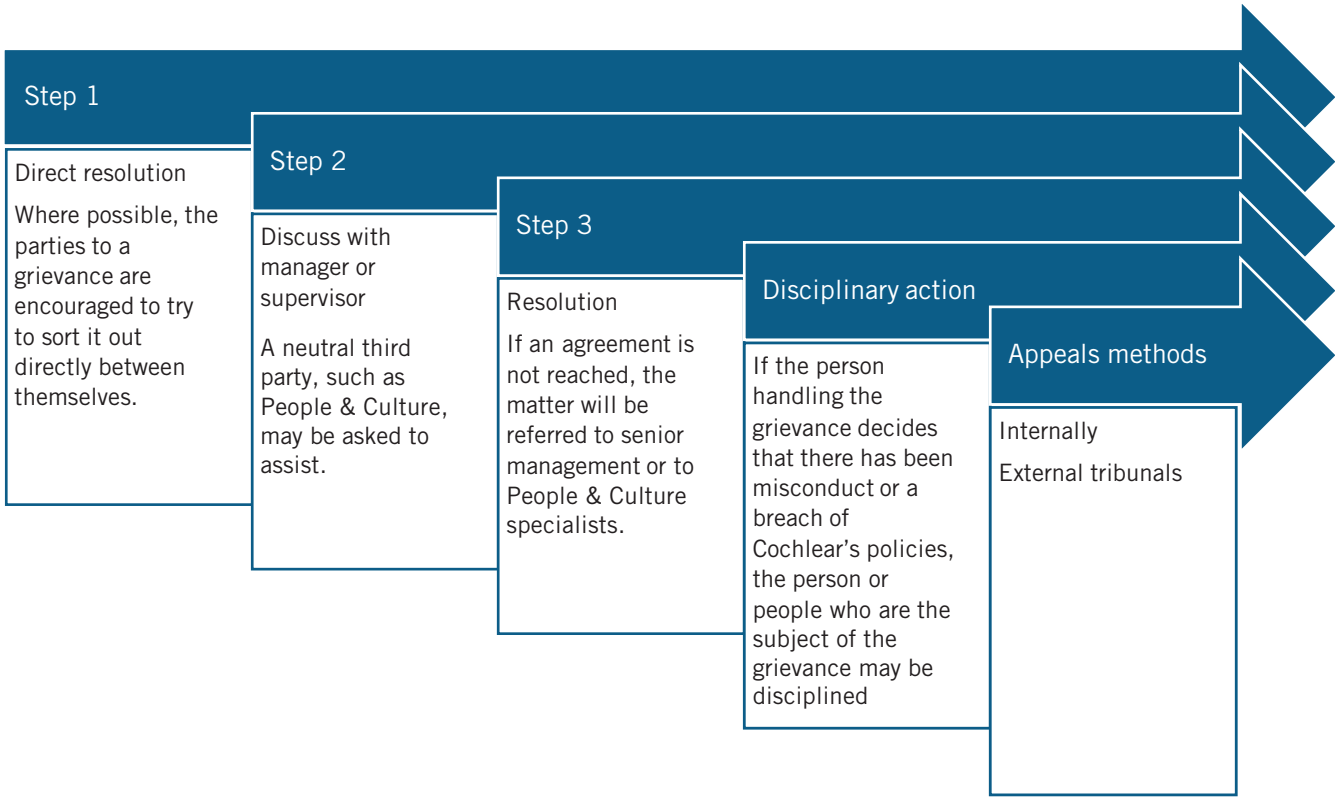
China has become a top five market for Cochlear and is one of its fastest growing markets, with significant potential for ongoing growth. More than five million people in China live with severe to profound hearing loss.

There is also a growing preference among Chinese customers for products to be manufactured domestically, and Cochlear sees this as an important reason why it needs to be closer to its customers.

This investment is also very much aligned with the health agenda of the Chinese government, supporting its focus on encouraging innovation and entrepreneurship, strengthening the medical industry with world-class technology, and ultimately helping the citizens of China to live healthy, happy and full lives.

Workplace disputes

Workplace disputes are a common feature of many workplaces. To promote a fair and engaging workplace, Cochlear released a Grievance Procedure which outlines the process by which disputes within the workplace can be resolved. This involves direct negotiation between the employee and their line manager as well as having People & Culture assist with resolution. The business also gives employees the right to seek resolution within the relevant Australian government tribunal.



Source 22.9 A flowchart of the grievance procedure at Cochlear Limited

22.5 Effectiveness of human resource management

Indicators

In 2018, the Association of Talent Development listed Cochlear Limited as one of the BEST Learning Organisations. The global BEST awards recognise organisations that demonstrate enterprise-wide success as a result of employee talent development.

Corporate culture

The Cochlear objectives regarding people and culture are:

- Attract and recruit talent.
- Build a diverse and inclusive workplace.
- Develop talent.

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Video 22.2 Employees from around the globe share what inspires them to work at Cochlear.

- Support the health and wellbeing of its workforce.

The profile of a Cochlear employee is that of a passionate and highly-skilled professional who understands how their work contributes to the business strategy, who has insight into the customer's needs and what role they play in meeting these needs.

Changes in employee turnover

Cochlear Limited enjoys high retention rates. In 2020, the staff turnover was just over 9 per cent. Despite the impact of COVID-19, employee numbers remained stable.

Employee satisfaction

An annual internal global engagement survey gives all employees the opportunity to provide feedback on their work experiences. In FY20, 93% of employees completed the global engagement survey with an overall engagement score remaining very strong at 80%, consistent with prior years' results. 93% of employees reported they felt proud to tell people they work for Cochlear.

The introduction of Flex@Cochlear, the flexible working program, led to 87 per cent of employees indicating that they have flexibility to balance work and personal responsibilities.

End-of-chapter tasks

Multiple-choice questions

1 The human resource function at Cochlear is known within its organisation as:

A Cochlear Human Resources
B Cochlear People & Culture
C Cochlear Personnel
D Cochlear People and Performance

2 Human resources within Cochlear is based on the HEAR behaviours. Which of the following represents the HEAR behaviours?

A Hear the customer, Embrace change and innovate, Aspire to win, Remove boundaries
B Hear the customer, Embrace profit, Aspire to be your best, Remove boundaries
C Hear the client, Embrace change and innovate, Aspire to win, Remove limitations
D Hear the client, Embrace opportunities, Aspire to win all, Remove limitations

3 Which of the following describes how Cochlear responded to changes in its human resource function due to recent changes in Australian and global economic conditions?

A Due to a significant decline in revenue, senior Cochlear executives took at least a 20 per cent reduction in their base salary to ensure all employees of the business could maintain their employment and regular salaries within the organisation.
B Cochlear closed its Sydney headquarters and all employees took unpaid leave
C Due to a significant rise in revenue, all staff within the business were awarded a 20 per cent wage increase.
D 50 per cent of non-manufacturing employees were made redundant.

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4 Which of the following describes the role of Cochlear's My Performance Pathway?

A Cochlear People & Culture use this program to guide employees and their managers on strategies to improve their performance and grow their careers in the business.

B Cochlear People & Culture use this program to guide customers on strategies to improve their use of the businesses products.

C Cochlear People & Culture use this program to recruit new employees to the business and induct them on processes within the organisation.

D Cochlear People & Culture use this program to identify employees who are at risk of having their employment within the business terminated.

5 Which of the following was the reason for Cochlear's decision to establish a manufacturing plant in Chengdu, China?

A To take advantage of highly skilled labour not available in the Australian workforce.

B To take advantage of expert technical assistance in addition to that was available in Australia.

C To take advantage of the low cost labour which sits at less than 10 per cent of current Australian labour cost

D To increase global production capacity to meet growing demands in China and neighbouring countries.

Short-answer questions

1 Explain how Cochlear People & Culture utilise rewards to motivate its different categories of employees.

2 Examine three different global factors impacting upon the human resource function within Cochlear.

Extended-response question

Analyse the role of Cochlear in achieving corporate social responsibility with its human resource function.

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Glossary

Absenteeism
Employees not attending work, usually for reasons such as illness or family responsibilities.

Accounting and finance function
Provides the financial information needed for sound and viable decision-making.

Accounts payable
The money a business owes to its suppliers and service providers. Accounts payable is also known as creditors or trade creditors.

Accounts receivable
A current asset that represents money owed to the business in the short term. This money is owed to the business by customers who are yet to pay for goods or services they have already received. Accounts receivable is also known as debtors.

Accounts receivable turnover ratio
This ratio is a measure of how long, on average, account customers take to pay the invoices sent to them by the business. It indicates how promptly customers who have been given credit pay for the products they have bought.

Acquisition
The stage in the human resource cycle that involves staffing needs, recruitment and selection.

Appreciation
An upward movement or increase in value of the Australian dollar compared to any other currency.

Arbitration
Involves a commissioner hearing the cases put forward by both parties in an industrial dispute and then making a decision, which is legally binding on both parties.

Audit
An independent check of the financial records of a business by a certified accountant. Alternatively, it can be performed by the business's managers.

Award
A legal document that specifies the minimum working conditions that apply to all people employed in a common industry.

Bad debts
Debts that are unlikely to be paid. Debtors may have entered bankruptcy and are unable to pay their invoices. The business will have to reduce the value of accounts receivable in the balance sheet by writing off these debts.

Balance sheet
A snapshot on a particular day (usually the last day of the financial year) that shows the assets a business owns, the liabilities the business owes and the equity the owner has invested in the business. The balance sheet gives an indication of the financial stability of a business. It represents the accounting equation A = L + E.

Bankruptcy
A legal declaration that a person or business has more liabilities than assets. A consumer or business that is unable to pay its bills may be formally declared bankrupt by a court. A business may declare itself bankrupt voluntarily as part of the process of closing the business.

Batch production
Producing a small number of the same item.

Behavioural segmentation
The process of dividing a market based on people's knowledge of, attitudes towards and use of a product.

Benchmarking
The process of measuring performance against established standards, such as a comparison of a firm's performance against standards set by competitors in the same industry in the domestic market.

Bottleneck
Where output is limited by one aspect of operations.

BPAY
Payment of bills using online (internet) banking.

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Brand awareness
The extent to which consumers are aware of the existence of a particular product, its features, price and possible places of purchase.

Branding
The reputation that a business or product has developed over a period of time.

Break-even point
When total revenue from sales equals total costs of operations. Any increase in output and sales means the business will begin to make a profit.

Budget
A tool to evaluate the performance of a business by comparing actual results with planned results. A budget is usually drawn up as a spreadsheet illustrating the changes in data over time, such as weeks or months.

Capital
The money used for investment or starting a business.

Capitalised expenses
The costs incurred when financing a non-current asset added to the cost of the asset.

Cash flow management
Managing the movement of cash into and out of a business in order to identify cash flow problems and ways to improve the business's liquidity.

Cash flow statement
A financial report illustrating the movement of cash into and out of a business over time.

Certified agreement
A wage agreement that is negotiated between an employer and all its employees.

Collective bargaining
The common term used to describe negotiations over workplace disputes within an organisation.

Commercial bill (bill of exchange)
An agreement to repay the short-term loan plus interest to the lender on a specific date.

Common law
Law that is derived from previous court decisions made by a judge.

Competitive advantage
Refers to the features implemented by a business that create an advantage over its competitors.

Competitive positioning
Involves the formal process of a business determining how to differentiate itself from its competitors and, in doing so, develop strategies for the business to create value from those differences.

Component
A part or piece that is assembled with other components to create a finished good.

Computer-aided design (CAD)
Computer technology that allows architects, engineers and designers to draw and adjust designs using a computer.

Computer-aided manufacture (CAM)
Computer technology that directly links the design process to the manufacturing process using computers.

Conciliation
Is used when the Fair Work Commission offers suggestions to help resolve an industrial dispute. These recommendations are not legally binding.

Contract for service
Exists where employment is not ongoing and an agreed fee is paid to an independent contractor for the service provided by the contractor, usually for a fixed period.

Contract of service
Exists where an employee offers his or her services to an organisation on a regular basis and is subject to the lawful control and authority of the employer.

Cost centres
Centres that account for the expenses/costs incurred by each key business function (that is, operations, marketing, finance and human resources) in providing a product to consumers.

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Cost-plus pricing
A pricing strategy whereby the business considers the total cost to the business of manufacturing or providing a good or service to the consumer and then adds an amount to allow for a profit margin.

Credit card
A card that provides a line of credit to the user. The user can borrow money for payment to a merchant or as a cash advance to the user. A type of buy now, pay later plan.

Credit policy
The conditions under which a business is willing to allow other businesses to postpone their payment for goods and services they have bought from it; for example, how many days are permitted to pass before payment is due.

Credit rating
An assessment of a business's ability to repay loans based on its past financial performance and repayment of past loans. Credit ratings are usually expressed as letter grades, such as A–, B or C+.

Creditors
The businesses, financial institutions and individuals to which a business owes money. Also known as accounts payable.

Critical path analysis (CPA)
A scheduling tool used in an operation involving repetitive tasks, especially if the exact time each task will take is known.

Current assets
Assets (such as cash in the bank, accounts receivable and stock) that earn revenue for a business in the short term; usually within 12 months.

Current liabilities
Money that is owed to an external business or person that will be repaid in the short term; usually within 12 months.

Current ratio
This ratio, also known as the working capital ratio, is used to measure a business's ability to pay its current liabilities from its current assets. It is calculated by dividing the value of current assets by the value of current liabilities.

Customise
To change the features of a product to suit the precise preferences of a customer.

Database
Large amount of information stored on a computer and used to maintain the records of a business.

Debentures
A type of long-term debt finance that a business can acquire by offering a prospectus to the general public on the securities exchange. The business is offering an investment opportunity to people who want a higher return from a more risky investment.

Debt finance
Any type of loan that a business obtains that is issued with a promise of repayment on a certain date at a specific rate of interest.

Debtors
The businesses or individuals that owe money to a business. Also known as accounts receivable.

Demographic segmentation
The process of dividing a market into smaller markets based on customers' ages, genders, incomes, family size and levels of education.

Depreciation
(of assets) Occurs where assets (such as motor vehicles and equipment) lose value over time owing to wear and tear and the development of new technology.

Depreciation
(of currency) A fall in the value of a nation's currency against that of another currency. A nation's currency can fall in value due to a poorly performing economy or inflation. Currencies of other countries may increase in value because their economies are performing better.

Deregulation
The government's removal or reduction in controls and regulations on an industry or sector of the economy or market in order to achieve greater competition.

Derivative
A contract under which the buyer agrees to purchase something from the seller for a set

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price at a future point in time. It can be used to hedge (that is, reduce) financial risks, such as those created by the appreciation and depreciation of currencies.

Distribution channels
The channels by which a product is moved from the place of manufacture (the product's place of origin) to the consumer (the product's final user).

Dividend
The income earned from owning shares in a company. It is usually paid every six months and is based on the profits the company makes.

Drawings
Money taken out of a business by a sole trader or partner for their personal use.

Driving force
A force that pushes towards the need for change.

Economies of scale
By increasing the scale of operations, a business can lower the cost of producing each individual output as a result of cost savings and greater efficiency.

Efficiency
The achievement of maximum output with the minimum level of inputs. It involves achieving an objective without wasting resources and while keeping costs as low as possible.

EFTPOS
Electronic funds transfer at point of sale. EFTPOS allows customers to pay for their purchases electronically using their bank debit and/or credit card.

Electronic data interchange (EDI)
Use of computers, barcodes and scanner systems to monitor individual stock items and keep accurate records of inventory levels.

Employee
An individual who provides his or her skills to a business in return for a regular source of income.

Employer
An individual or organisation that pays others to work for its business.

Employer associations
Organisations that aim to promote the interests of employers within the business environment.

Employment relations function
Deals with the role of employees within an organisation.

Entrepreneur
A person who uses initiative to take a calculated risk to start a new business.

Equity
The owner's financial claim on the assets of the business. It is the original investment the owner made into the business by contributing capital or buying shares, plus any profit the business makes. Also called proprietorship or proprietor's funds.

Euro
The currency of the European Union. It was introduced in 1999, with notes and coins in circulation in 2002.

Exchange rate
The value of a country's money calculated in terms of another country's money.

Exclusive distribution
A form of distribution where there is a restriction on the number of products and/or availability of the product. The product is available at a very limited number of outlets.

Factoring
Occurs when a business sells its accounts receivable asset to a specialist factoring firm to create cash inflow for the business.

Fixed charge
Provides security over a specified physical asset.

Fixed costs
Costs that do not change when a business varies the amount of goods and services it produces. Rent is an example of a fixed cost.

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Floating charge
When the security is subject to day-to-day fluctuations, such as inventory.

Flow production
Producing a large number of items at the same time.

Formal training
Where an employee takes on a role similar to that of a student within the organisation, is shown how to work with the new operations of the business, and is later assessed on their level of understanding.

Gantt chart
Records the number of tasks involved in each particular project and the estimated time needed for each task, but will not show the relationship between each of the tasks.

Gearing
How much debt finance the business has acquired to fund its operations compared to its use of equity finance.

Gearing: debt to equity ratio
This is a measure of how the assets of the business were funded through a mix of debt and equity. Higher debt indicates higher risk. It is a measure of the business's long-term financial stability.

Geographic segmentation
The process of dividing a market or customer group into smaller markets based on different geographic locations, such as nations, states or local government areas.

Global web strategy
Involves a business sourcing inputs from the cheapest regions, manufacturing where it is cheapest to do so, obtaining finance from the country with the lowest interest rates and distributing products to any nation that demands them.

Globalisation
Different national economies integrated into one market for easy trade of goods and services, and the development of a world economy owing to the increasing flow of goods, services, people, finance and information around the world.

Goal
A measurable and observable long-term aim. It identifies the business's direction and focus for the future. Goals may involve several objectives.

Goodwill
An intangible asset valued according to the advantage or reputation a business has acquired over time.

Grants
Financial gifts provided by government to assist businesses to establish or expand.

Grievance
A dispute between parties.

Grievance procedures
The rules and procedures that employees, unions and employers must follow in order to resolve a dispute.

Gross profit
The revenue remaining after paying the cost of goods sold; that is, the expenses of purchasing the goods wholesale (wholesale cost) and transporting them to the business ready for sale (freight or cartage inwards).

Gross profit ratio (GPR)
This ratio is a measure of a business's profitability before expenses. It is calculated by dividing the value of gross profit by the value of sales. The result is usually expressed as a percentage.

Growth
The increase in the size of the business, often leading to an increase in profit.

Hedging
Any strategy or financial tool used to reduce the risk of loss resulting from financial transactions, such as converting one currency to another.

Human resource cycle
The cycle of acquisition, development, maintenance and separation of employees.

Human resource department
A specialist unit in a business that has as its main role the management of the issues involved in the employment relationship.

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Human resource function
Deals with the relationship between the owners of a business and the people who work for the business.

Human resource management
The process of managing staff within an organisation. It focuses on the relationship between the employer and the employee and how each of these stakeholders is able to work to achieve the goals of the business and their own individual goals.

Human resources
The process of managing employees in a workplace.

Implied warranty
Regardless of whether a product is carrying a warranty, a business must, by law, either refund a client's money or offer an exchange of the good should the good be recognised to have been faulty at the time of leaving the store.

Income statement
A summary of a business's revenue and expenses over a set financial period. It is completed in order to determine the business's profitability and efficiency. Also known as a revenue statement or profit and loss statement.

Induction
Introduces new employees to the business, allows them to become familiar with the workings of the firm and provides them with information about the firm's day-to-day operations.

Industrial dispute
A problem that arises between an employer and either a group of employees or an individual employee at a workplace.

Industrial markets
Markets in which goods that are used as supplies in the production process are traded.

Informal training
Where an employee is shown or modelled the correct skills through the use of a coach or mentor, or by learning the work on the job.

Inputs
The raw materials, components and parts used to produce a good or supply a service.

Insolvency
Occurs when expenditure has exceeded income for an unacceptable length of time and the firm is unable to pay its debts.

Insurance premium
The cost of obtaining insurance. The premium is based on the risk of the insured event actually occurring.

Intangible asset
An asset that does not physically exist and therefore is not written on a business's balance sheet unless the business is to be sold. However, it is of value to the business because it can earn revenue from the asset. Intangible assets include a business's good reputation, trademark, design or brand name.

Intensive distribution
Occurs when a product is readily available to a wide selection of businesses or locations.

Interdependence
The reliance of different parts of an organisation on each other to perform their task or role.

Interest rate
The rate of interest charged per year as a proportion of the amount borrowed.

Intermediate markets
Markets in which retail businesses purchase products that have been produced by other organisations. Also known as wholesalers.

Intrinsic reward
A reward that comes from within the person. In the case of employment, it could be the feeling of satisfaction that comes with doing a job well.

Inventory
Includes the raw materials and input supplies used in the production process, the goods that are partially processed and the firm's finished products, which are also known as stock.

Invoice
A bill sent to a customer requiring payment by a specified date. Invoices are primary documents

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in accounting because they are records of credit sales.

Involuntary separation
Occurs when the employer terminates the employment contract. This may include involuntary redundancy or dismissal.

Job description
Written statement describing the duties, tasks and responsibilities associated with a particular job.

Job production
Producing a single unique item.

Job rotation
A system in which an employee is moved through a variety of tasks so as to increase their individual skill development and minimise boredom associated with repetitive tasks.

Job specification
Written statement describing the key skills, experience and qualifications needed for a particular job.

Jugaad
Originating in India, this term pertains to making use of what resources are available to complete a project imminently before it is due; a quick fix to a problem using whatever is available.

Lead time
The time it takes for a supplier to provide its customer with the goods ordered; that is, the time between the supplier's receipt of an order for goods until the delivery of those goods to the purchaser.

Lease
A contract allowing use of another person's asset (such as land, equipment or services) for a specific period of time and at a set fee.

Leasing finance
Involves a business 'hiring' the assets needed for a period of time, such as a year. The business has the right to use the asset (such as a car, machinery or a building) without having to buy it. A regular fee must be paid, usually monthly, which is an expense for the business.

Legislation
Laws made by parliament.

Level of disputation
The number of times each year issues arise between an employer and its employees.

Liability
The amount of money owed to individuals and businesses (creditors; for example, suppliers or institutions such as a bank).

Liquidity
A measure of how quickly an asset may be converted into cash and therefore determines the ability of the business to pay short-term debts as they fall due.

Long term
Longer than a 12-month period.

Loss leader
A pricing strategy that involves providing a limited number of goods at a price that generates minimal profit or even a loss to encourage consumers to purchase goods from the business.

Maintenance
Providing the working conditions and work environment that motivate staff to be increasingly productive, gain satisfaction from their work and remain loyal to the firm.

Market segmentation
The process of breaking down a total market into small markets based on the similar characteristics of a customer group.

Market share
The percentage of total sales a business has compared with its competitors within a particular market.

Market share analysis
An examination of the sales performance of a business and its comparison with that of its direct competitors.

Market skimming
A pricing strategy that is used when a business wants to recover the high costs involved in establishing a product and releasing it onto the marketplace by setting a high price.

Marketing
The process of developing a product and implementing a series of strategies aimed at

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correctly promoting, pricing and distributing the product to a core group of customers.

Marketing function
Involves finding out what consumers want and need and attempting to link the results of this research to the business's product.

Marketing mix
The process of developing a product that meets the needs of consumers and implementing a series of promotional, pricing and distribution strategies that will encourage consumers to purchase the product.

Marketing profitability analysis
The process of evaluating the financial (such as profit and sales) and non-financial (such as brand awareness and customer satisfaction) benefits that have been achieved by a specific marketing plan against the costs of implementing the plan.

Mass market
The market where the products are aimed at all consumers.

Matching principle
Involves using the appropriate finance for purchasing an asset. Current assets should be purchased with short-term finance while non-current assets are purchased with long-term finance. The term of the loan should be matched to the economic life of the new asset.

Mediation
Occurs where an independent party with no ties to either stakeholder is asked to assist the conflicting stakeholders to reach a settlement.

Merger
The joining together of two businesses to form one business.

Monetary policy
Steps taken by the Reserve Bank of Australia to affect the finance market and assist the federal government to achieve its goals of low inflation and economic growth.

Monetary rewards
Rewards given to employees that involve an additional monetary payment beyond their minimum legal entitlements.

Net profit
The final amount of revenue remaining after all expenses have been paid.

Net profit ratio (NPR)
This ratio is a measure of a business's profitability after all expenses have been paid. It is calculated by dividing the value of net profit by the value of sales. The result is usually expressed as a percentage.

Niche market
A small area of trade within the economy, often involving specialised products.

Non-monetary benefits
Include greater job variety, more flexible working hours, increased status in the workplace or community and intrinsic rewards.

Normalised earnings
The earnings adjusted to take into account cyclical upswings or downswings in the economy, or to remove one-time influences.

Objectives
A series of short-term steps or targets needed to achieve the final goal.

Obsolescence
Loss of value of, or need for, an object, service or practice by its becoming less suitable for use.

On-costs
The additional costs to a business of employing staff. As well as paying a wage or salary, a business must pay staff leave for sickness, holidays and maternity leave. A business must also contribute to the retirement savings of employees by paying superannuation. These are legal requirements.

Operations function
The physical production of a good or the provision of a service, such as a dental visit.

Opportunities
Changes in a firm's external environment that may present a benefit for the firm or present the firm with an opportunity for improvement or expansion.

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Ordinary shares
Provide part-ownership in a public company; shareholders receive a dividend as their share of the business's profits.

Outputs
What is made or supplied by the operations process.

Outsourcing
Occurs when a business takes a part of a key function and gives it to another company to perform.

Overdraft
A loan arrangement with the bank to draw more money than is in an account, up to a maximum limit. Interest is charged daily on the overdrawn balance.

Patent
Gives the owner the exclusive rights to sell, market, license or make a profit from an invention, innovation or production technique.

Payment in advance
Method of payment in which the goods are actually paid for before they are supplied.

Penetration pricing
A pricing strategy whereby prices are set at the lowest possible price to gain an immediate group of customers.

Performance appraisal
A formal assessment of how well a person is working – the person's strengths. It provides a basis for such matters as future training needs, pay rises, promotions and possible further development.

Place
The methods of distribution and availability of a good from different outlets and locations.

Placement
An additional share issue that is offered to specific institutions and specific investors to raise up to 15 per cent of the business's current capital base.

Positioning
The image that a product has in the mind of the consumer. How consumers compare one product against alternative products.

Price
The cost to the consumer of buying a good or service.

Price discrimination
A business giving preference to some retailers by providing them with stock at lower prices than are offered to the retailers' competitors.

Price-quality interaction
The degree to which price influences the perceived quality of a good or service held by consumers. A high price is generally associated with luxury and prestige.

Primary data
Information that is collected for the specific purpose for which it will be used.

Primary market
Market in which new shares are floated and sold to the general public for the first time and the company listed on the exchange.

Private company
An incorporated business legal structure that has limited liability; however, it cannot advertise to the public for shareholders.

Process technology
The improvements in the machines, equipment and devices used to transform inputs into outputs.

Product analysis
Examines the current position of the goods and/or services that a business produces in the marketplace.

Product-deletion pricing
A pricing strategy that is used to clear stock that a business believes is no longer selling or attracting interest from consumers.

Product life cycle
The different phases that a business's product/s will often go through over the course of its existence.

Productive capacity
The maximum potential output of a business.

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Productivity
A measure of how efficiently goods and services are produced. It is usually measured in terms of output per labour hour.

Profit
What remains from revenue after all expenses have been paid.

Profit and loss statement
See Income statement.

Profit margin
The difference between the sale price of a product and the cost to make the good or supply the service.

Profitability
The earnings of the business after expenses have been paid.

Prospectus
A company's invitation to investors to buy shares in the company. The prospectus is a brochure that describes the business and indicates what shareholders will receive if they invest by purchasing shares.

Psychographic segmentation
The process of dividing a market into smaller markets based on consumers' lifestyles, personalities, values and interests.

Psychological factors
The personal characteristics of individuals that influence their behaviour. These factors relate to the way people think and their attitudes.

Quality assurance
Establishing and using a set of procedures and/or processes that will prevent products from having problems (such as faults or errors).

Quality circles
Regular meetings of a group of employees from different sections of the business to discuss issues arising in the workplace.

Quality control
Checking resources and products in all stages of the production process; includes feed-forward, concurrent and feedback controls.

Recruit
To accumulate a pool of potential candidates for a job. It is from this pool that the business must make its selection.

Regionalism
The classification of the world's nations into different regions based on their geography and economic links. The different regions may be classified as North America, Europe, South-East Asia, Asia-Pacific, Africa and South America.

Relationship marketing
The process of building and maintaining long-term relationships with customers.

Remuneration
How much a job is worth; that is, the pay and entitlements to be provided to the person employed to do the job.

Resource markets
Markets in which the production and sale of raw materials occur.

Restraining force
A force that holds back a business and resists change.

Retained profit
Net profit that is reinvested into the business. Retained profit is added to equity because it increases the owner's claim on the assets of a business.

Retrenched
Workers are retrenched when their services are no longer needed because the business they work for has downsized, closed a division or outsourced a function and therefore requires fewer workers.

Return on equity (ROE) ratio
This ratio measures the profitability of the business and the return generated for the owner's investment in the business.

Rights issue
Issue of shares that is offered at a special price to existing shareholders in proportion to their current share ownership in that company.

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Robotics
The development of robots, which are machines that can be programmed to perform a variety of repetitive tasks.

Salary
An annual rate of pay, divided into equal pay periods.

Sales analysis
An examination of the sales of a particular product among different customer groups, by sales representatives and during various times of the year.

Sales forecast
The predicted future sales a business expects to make during the year considering the business's internal and external environments.

Sales mix
The combination of different products and services that make up the total sales of a business.

Secondary data
Information that already exists, having already been collected for another purpose.

Secondary market
Market in which existing shares and securities are bought and sold by investors without the involvement of the company itself.

Secured creditor
A bank, financial institution, supplier or individual that is owed money by a business and holds security over an asset the business owns in case the loan is not repaid.

Selection
A screening process in staff acquisition. The information gathered about job applicants is reviewed and the most appropriate applicant is chosen.

Selective distribution
Involves the use of only a limited number of stores/locations to sell or distribute a product.

Selling approach
Involves a business placing emphasis on strategies aimed at convincing consumers of the need to buy a product.

Separation
The ending of an employment contract. Separation may come from either the employee or the employer.

Share purchase plan
Companies can offer up to $15 000 in new shares to each existing shareholder at a discounted price.

Shop steward
A union's representative in the workplace.

Short term
In less than a 12-month period.

Social responsibility
Involves taking actions or making decisions that are morally and ethically correct and are in the best interests of the community.

Sole trader
An unincorporated business with one owner.

Solvency
The ability of a business to pay both short- and long-term liabilities as they fall due. It is a measure of whether a business is financially stable.

Specialisation
A high level of skill at a specific task or role.

Staff turnover
The rate at which employees leave a business.

Standard of living
A measure of an individual's quality of life, partly based on what goods and services the individual can afford to buy.

Stock movement
The physical movement of stock into a business when it is bought as inventory and out of a business when it is sold.

Stock-out
A situation in which a business runs out of inventory.

Strategic
Used to describe long-term planning performed by senior managers.

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Strategic role of marketing
The ability of the business to develop goods and services that develop a long-term relationship with a specific customer base and, in so doing, generate sales and revenue for the organisation.

Subsidiary
A business that is partly or completely owned by another company.

Sugging
A disguised marketing process that uses general questions in a survey or questionnaire to determine the interests and needs of a consumer and then offers the consumer a product that the business believes caters to the consumer's needs.

Superannuation
Compulsory savings (additional to the employee's wage or salary) paid by the employer and invested in a superannuation fund on behalf of the employee.

Superannuation fund
All superannuation payments are invested in a superannuation fund. The fund invests the superannuation in, for example, shares or property to earn a return for the employees whose superannuation has been invested with the fund.

Takeover
One business buying a controlling interest in another business, such as by becoming a majority shareholder.

Tangible
Able to be seen and felt.

Task analysis
The breakdown of exactly how the manufacture of a good, or activities to provide a service, is to be accomplished.

Task design
Deciding how a task will be completed.

Tax concession
A reduction in the tax payable by businesses that undertake certain areas of research and development.

Technology
The equipment, materials and knowledge that are available to help businesses perform certain functions or make products.

Threats
Changes in a firm's external environment that may present problems for the firm.

Total quality management (TQM)
An approach to quality control that relies on continuous improvement in all aspects of the business. It is often referred to as kaizen and is very evident in Japanese manufacturers, such as Toyota.

Trade credit
Money owed to a creditor for the purchase of supplies and services that have already been provided.

Trademark
A symbol or name that a business uses and has registered to represent its product. It is part of a business's intellectual property.

Trading bloc
A group of nations that have formed a trade alliance by signing a multilateral trade agreement.

Training
Any activities that are aimed at improving an employee's present and future performance in the workforce.

Transaction exposure
The risk that exchange rates will change after companies have entered into an international financial contract that could lead to increased costs and reduced profits for the business.

Transformation
Any change to inputs that adds value and converts them into outputs.

Transport logistics
The organisation of the physical movement of inputs and outputs from their point of origin to their destination. The route, method and speed of transportation are all factors to consider when delivering inputs and outputs.

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Triple bottom line (TBL)
A measure of a business's financial, social and environmental performance.

Unconscionable conduct
Conduct that is morally unacceptable.

Unsecured loan
A loan that does not have an asset as security. If the loan is not repaid, the creditor who lent the money receives nothing. Unsecured loans have a much higher rate of interest due to the increased risk involved.

Value add
Occurs when an operations process combines inputs with labour and facilities so that the value of the output is increased, and is greater than the cost of its individual inputs.

Variable costs
Costs that change when a business varies the amount of goods and services it produces. For example, the more a business produces, the more raw materials it will need. The cost of raw materials is an example of a variable cost.

Venture capital
Capital acquired from a specialist venture financial institution that seeks to become a part-owner in the business.

Vertically integrate
When a business purchases a controlling interest in other businesses in its supply chain.

Wage
An hourly rate of pay. It may include overtime payments for work outside normal hours.

Warranty
An agreement by the seller of a product that the seller will be responsible for the repair or replacement of the product if it is found to have a defect in its quality, condition or quantity.

Worker satisfaction
The level of satisfaction demonstrated by employees towards their employer and the nature of the job tasks.

Working capital
The current assets used in the day-to-day running of a business and to pay current liabilities that fall due.

Working conditions
The non-wage features of an employee's workplace contract, such as hours of work and occupational health and safety issues.

World's best practice
Comparison of a firm's performance with the highest standards achieved worldwide.

Write off
To eliminate an asset from the balance sheet because it has no value, such as an item of equipment that has reached the end of its useable life or perishable stock past its use-by date. Income may also be written off from a customer that is unable to pay its invoice and is therefore a bad debt.

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