CAMBRIDGE UNIVERSITY PRESS



CAMBRIDGE YEAR 12 (HSC) BUSINESS STUDIES

Fourth Edition

Marianne Hickey • Tony Nader • Tim Williams

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

CAMBRIDGE
UNIVERSITY PRESS

University Printing House, Cambridge CB2 8BS, United Kingdom

One Liberty Plaza, 20th Floor, New York, NY 10006, USA

477 Williamstown Road, Port Melbourne, VIC 3207, Australia

314–321, 3rd Floor, Plot 3, Splendor Forum, Jasola District Centre, New Delhi – 110025, India

79 Anson Road, #06–04/06, Singapore 079906

Cambridge University Press is part of the University of Cambridge.

It furthers the University's mission by disseminating knowledge in the pursuit
of education, learning and research at the highest international levels of excellence.

www.cambridge.org
Information on this title: www.cambridge.org/9781316648834

© Marianne Hickey, Tony Nader, Tim Williams 2005, 2011, 2015, 2017

This publication is in copyright. Subject to statutory exception
and to the provisions of relevant collective licensing agreements,
no reproduction of any part may take place without the written
permission of Cambridge University Press.

First published 2005
Second Edition 2011
Third Edition 2015
Fourth Edition 2017
20 19 18 17 16 15 14 13 12 11 10 9 8 7 6 5 4 3

Cover and text designed by eggplant communications
Typeset by eggplant communications
Printed in Malaysia by Vivar Printing

*A catalogue record for this book is available from
the National Library of Australia at* www.nla.gov.au

ISBN 978-1-316-64883-4 Paperback

Additional resources for this publication at www.cambridge.edu.au/GO

Reproduction and Communication for educational purposes
The Australian *Copyright Act 1968* (the Act) allows a maximum of
one chapter or 10% of the pages of this publication, whichever is the greater,
to be reproduced and/or communicated by any educational institution
for its educational purposes provided that the educational institution
(or the body that administers it) has given a remuneration notice to
Copyright Agency Limited (CAL) under the Act.

For details of the CAL licence for educational institutions contact:

Copyright Agency Limited
Level 12, 66 Goulburn Street
Sydney NSW 2000
Telephone: (02) 9394 7600
Facsimile: (02) 9394 7601
Email: memberservices@copyright.com.au

Reproduction and Communication for other purposes
Except as permitted under the Act (for example a fair dealing for the
purposes of study, research, criticism or review) no part of this publication
may be reproduced, stored in a retrieval system, communicated or
transmitted in any form or by any means without prior written permission.
All inquiries should be made to the publisher at the address above.

Cambridge University Press has no responsibility for the persistence or
accuracy of URLs for external or third-party Internet websites referred to in
this publication and does not guarantee that any content on such websites is,
or will remain, accurate or appropriate. Information regarding prices, travel
timetables and other factual information given in this work is correct at
the time of first printing but Cambridge University Press does not guarantee
the accuracy of such information thereafter.

Contents

About the authors vi
Acknowledgements vii
How to use this resource viii
Case Study: Domino's Pizza Enterprises Limited x

TOPIC 1
Operations 1

Chapter 1 – Role of operations management 2
1.1 Introduction 3
1.2 Strategic role of operations management 4
1.3 Goods and/or services in different industries 7
1.4 Interdependence with other key business functions 10
End-of-chapter tasks 13

Chapter 2 – Influences 15
2.1 Introduction 16
2.2 Globalisation 16
2.3 Technology 20
2.4 Quality expectations 23
2.5 Cost-based competition 23
2.6 Government policies 24
2.7 Legal regulation 25
2.8 Environmental sustainability 27
2.9 Corporate social responsibility 28
End-of-chapter tasks 32

Chapter 3 – Operations processes 35
3.1 Introduction 36
3.2 Inputs 36
3.3 Transformation processes 39
3.4 Outputs 48
End-of-chapter tasks 52

Chapter 4 – Operations strategies 55
4.1 Introduction 56
4.2 Performance objectives 56
4.3 New product or service design and development 60
4.4 Supply chain management 61
4.5 Outsourcing 66
4.6 Technology 67
4.7 Inventory management 69
4.8 Quality management 72
4.9 Overcoming resistance to change 76
4.10 Global factors 78
End-of-chapter tasks 84

Chapter 5 – Operations at Domino's 87
5.1 Introduction 88
5.2 Role of operations management 88
5.3 Influences 89
5.4 Operations processes 91
5.5 Operations strategies 94
End-of-chapter tasks 98

TOPIC 2
Marketing 100

Chapter 6 – Role of marketing 102
6.1 Introduction 103
6.2 Strategic role of marketing goods and services 103
6.3 Interdependence with other key business functions 106
6.4 Production, selling and marketing approaches 108
6.5 Types of markets 109
End-of-chapter tasks 114

Chapter 7 – Influences on marketing 117
7.1 Introduction 118
7.2 Factors influencing customer choice 118
7.3 Consumer laws 123
7.4 Ethical aspects of marketing 126
End-of-chapter tasks 133

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Contents

Chapter 8 – Marketing process 135
8.1 Introduction 136
8.2 Executive summary 136
8.3 Situational analysis 136
8.4 Market research 140
8.5 Establishing market objectives 143
8.6 Identifying the target market 144
8.7 Developing marketing strategies 146
8.8 Implementation, monitoring and controlling 147
End-of-chapter tasks 152

Chapter 9 – Marketing strategies 155
9.1 Introduction 156
9.2 Market segmentation 156
9.3 Product/service differentiation and positioning 160
9.4 Products 161
9.5 Price 162
9.6 Promotion 164
9.7 Place/distribution 166
9.8 People, process and physical evidence 168
9.9 E-marketing 169
9.10 Global marketing 170
End-of-chapter tasks 176

Chapter 10 – Marketing at Domino's 179
10.1 Role of marketing 180
10.2 Influences on marketing 181
10.3 Marketing process 183
10.4 Marketing strategies 184
End-of-chapter tasks 189

TOPIC 3
Finance 192

Chapter 11 – Role of financial management 194
11.1 Introduction 195
11.2 Strategic role of financial management 195
11.3 Objectives of financial management 195
11.4 Interdependence with other key business functions 204
End-of-chapter tasks 207

Chapter 12 – Influences on financial management 210
12.1 Introduction 211
12.2 Internal sources of finance 212
12.3 External sources of finance 212
12.4 Financial institutions 220
12.5 Influence of government 224
12.6 Global market influences 224
End-of-chapter tasks 229

Chapter 13 – Processes of financial management 232
13.1 Planning and implementing 233
13.2 Monitoring and controlling 239
13.3 Financial ratios 248
13.4 Limitations of financial reports 255
13.5 Ethical issues related to financial reports 259
End-of-chapter tasks 263

Chapter 14 – Financial management strategies 265
14.1 Introduction 266
14.2 Cash flow management 266
14.3 Working capital management 269
14.4 Profitability management 275
14.5 Global financial management 280
End-of-chapter tasks 290

Chapter 15 – Finance at Domino's 293
15.1 Role of financial management 294
15.2 Influences on financial management 296
15.3 Processes of financial management 298
15.4 Financial management strategies 305
End-of-chapter tasks 307

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

TOPIC 4
Human resources 308

Chapter 16 – Role of human resource management 310

16.1 Introduction 311
16.2 Strategic role of human resources 311
16.3 Interdependence with other key business functions 312
16.4 Outsourcing 314
End-of-chapter tasks 319

Chapter 17 – Key influences 322

17.1 Introduction 323
17.2 Stakeholders 323
17.3 Legal – the current legal framework 329
17.4 Economic 335
17.5 Technological 337
17.6 Social 337
17.7 Ethics and corporate social responsibility 338
End-of-chapter tasks 343

Chapter 18 – Processes of human resource management 345

18.1 Introduction 346
18.2 The human resource cycle 346
18.3 Acquisition 346
18.4 Development 351
18.5 Maintenance 353
18.6 Separation 355
End-of-chapter tasks 359

Chapter 19 – Strategies in human resource management 362

19.1 Introduction 363
19.2 Leadership style 363
19.3 Job design 365
19.4 Recruitment 366
19.5 Training and development 367
19.6 Performance management 368
19.7 Rewards 370
19.8 Global 372
19.9 Workplace disputes 372
End-of-chapter tasks 377

Chapter 20 – Effectiveness of human resource management 379

20.1 Indicators 380
End-of-chapter tasks 385

Chapter 21 – Human resources at Domino's 387

21.1 Role of human resource management 388
21.2 Key influences 388
21.3 Processes of human resource management 393
21.4 Strategies in human resource management 394
21.5 Effectiveness of human resource management 396
End-of-chapter tasks 398

Solutions to end-of-chapter multiple-choice questions 400
Glossary 402
Index 413

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

About the authors

Marianne Hickey

Marianne Hickey, BA Dip Ed, obtained her degree from Macquarie University, majoring in Economics. She is a highly experienced teacher of Social Sciences in New South Wales schools. Currently teaching at Epping Boys High School, she has taught Business Studies since its inception at Epping. Marianne has also taught senior Geography and Economics as well as junior Social Science subjects such as Commerce. Marianne has experience as a year coordinator and for many years took part in marking the HSC Economics papers.

Tony Nader

Tony Nader is a highly experienced teacher of Business Studies in New South Wales schools. He has been an HSC exam marker and has written exam material and books for Commerce, Economics and Business Studies. Tony also lectures HSC Business Studies students in preparation for their final exam. Tony has served as a Head Judge, assessor, senior marker and member of the Examination Committee for the BOSTES Economics course and was also a member of the Catholic Schools Secondary Association Economics Trial Committee. Tony also writes a number of independent Business Studies exams. He is currently HSIE Coordinator at Marist Catholic College Penshurst.

Tim Williams

Tim Williams began a career as an accountant in the late 1980s before moving into the hospitality industry. An accidental move into teaching occurred in the early 1990s when Tim spent five years as a casual teacher with the New South Wales Department of Education. Following this he entered the private education system and spent over 10 years with SCEGGS Redlands in North Sydney. His time there culminated in the position of Head of Social Sciences, administrating both Board of Studies and International Baccalaureate courses. Tim taught at Abbotsleigh School for Girls until a move to South Australia. He is now the head of Business and Enterprise at Eynesbury Senior College.

Author acknowledgements

Marianne Hickey would like to thank Richard Hickey, Sarah Hickey, Alicia Catron, Jessica Pintado and Laura Hickey for their ongoing support.

Tony Nader would like to thank Antoinette Nader, Matthew Nader, Harriet Jordan and Linda Kowarzik. This fourth edition would not have been possible without their efforts and patience.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Acknowledgements

The authors and publisher would like to thank John Clowes (The King's School) and Yvonne Tarazi (St Maroun's College) for kindly reviewing this book and providing feedback.

The author and publisher wish to thank the following sources for permission to reproduce material:

Cover: © Getty Images / 4 X 6.

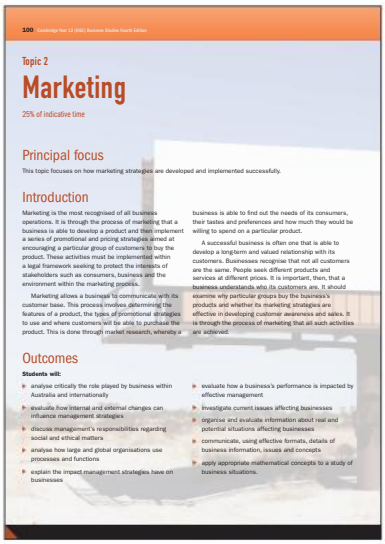
Images: © Getty Images / Greg Pease, Topic 1 Opener / Mint Images, Chapter 1 Opener / SMH, 1.3 / STR, 1.6 / Bloomberg, 1.7 / Hero Images, 1.8 / Dave and Les Jacobs, 1.13 / Ian Lishman, Chapter 2 Opener / Jose Luis Peaez Inc, 2.1 / Carolyn Hebbard, 2.4 / Alberto Graziani, 2.5 / Yagi-Studio, 2.6 / Maciej Frolow, 2.8 / Juanmonino, 2.11 / fotog, 2.12 / AaerreRinne, 2.14 / hjalmaeida, 2.16 / Shannon Fagan hjalmeida, Chapter 3 Opener / Chris Ryan, 3.3 / Hero Images, 3.4 / Reza Estakhrian, 3.5 / Phil Boorman, 3.7 / matspersson0, 3.13 / lovro77, 3.16 / PeopleImages, 3.21 / Thomas Trustschel, 3.23 / Richard Drury, 3.25 / Monty Rakusen , Chapter 4 Opener / runeer, 4.1 / Bloomberg, 4.3, 4.20, 7.8, 8.8, 8.2, 9.6, 9.8, 9.11, 11.10, 12.15, 13.13, 17.7 / sharply_ done, 4.4 / lucylul, 4.6 / Andersen Ross, 4.10 / Morsa Images, 4.13 / Dazman, 4.14 / Dave and Les Jacobs, 4.22 / pedphoto36pm, 4.23 / Yegor Aleyev, 4.24 / Musketeer, 428 / Tom Merton, 4.30 / Ethan Miller, 4.32 / fstop Images – Patrick Strattner, Topic 2 Opener / RICOWde, Chapter 6 Opener / mediaphotos, 6.1 / Bob Chamberlin, 6.3 / TPG / Contributor, 6.4 / Blend Images – Erik Isakson, 6.6 / Jitalia17, 6.7 / Lori Andrews, 6.8 / Porta Images, 6.11 / Tom Merton, Chapter 7 Opener / Daniel Leal – Olivas, 7.3 / Blankstock, 7.4 / gilaxia, 7.5 / YinYan, 7.6 / ThamKC, 7.70 / kokkai, 7.9 / Peter Ptschelinzew, 7.10 / Giorgio Majno, 7.11 / akirbs, 7.12 / sutiporn, 7.14 / Justin Pumfrey, 7.15 / JamieB, Chapter 8 Opener / Robert Daly, 8.5 / Peter Dazeley, 8.6 / Scott Barbour, 8.9 / Cameron Spencer, 8.13 / Marka, 8.14 / Comstock, 8.15 / Fairfax Media, 8.16 / Andrew Watson, 8.17 / Aslan Alphan, 8.18 / Juanmonino, 8.20 / Henry Donald, Chapter 9 Opener / Danita Delilmont, 9.2 / Kwan Eschmann, 9.3 / Karim Sahib, 9.5 / Oliver Strewe, 9.7 / asiseelt, 9.9 / Jetta Productions, 9.10 / laflor, 9.13 / piranka, 9.14 / James D. Morgan, 9.15 / Zhang Peng, 9.17 / Beyond Images, Topic 3 Opener / elen Ashford, Chapter 11 Opener / B Busco, 11.1 / AnthonyRosenberg, 11.7 / Photofusion, 11.11 / littlehenrabi, 11.13 / Neustockimages, Chapter 12 Opener / Naila Ruechel, 12.3 / PeopleImages, 12.6 / Trinetter Reed, 12.9 / Peter Parks, 12.13 / Peter Dazeley, 12.18 / RapidEye, 12.19 / DNY59, Chapter 13 Opener / Monty Rakusen, 13.13, 14.21, 17.4 / PhotoAlto/Odilon Dimier, 13.6 / Image Source, 13.7 / Nick White, 13.10 / Karen Strauss, 13.14 / SeanShot, 13.17 / Henrik5000, 13.21 / zoranm, 13.22 / Gary Waters, 13.24 / Martin Barraud, 13.26 / Zero Creatives, 13.29 / gargantiopa, Chapter 14 Opener / elenaleonova, 14.4 / Kritchanut, 14.6 / mbbirdy, 14.8 / alexsi, 14.10 / JGI/ Jamie Grill, 14.12 / Dave and Les Jacobs, 14.14 / narvikk, 14.26 / PeopleImages, 14.29 / Mahla1, 14.31 / Yagi Studio, Topic 4 Opener / Klaus Vedfelt, Chapter 16 Opener / Chris Ryan, 16.1 / Alina555, 16.2 / Frederic Cirou, 16.5 / Brett Williamstown, 16.7 / Chad Baker/Jason Reed/Ryan Mcvay, Chapter 7 Opener / Olga Kashubin, 17.3 / vgajic, 17.4 / Tim MacPherson, 17.5 / Jupiterimages, 17.7 / Exra Bailey, 17.8 / Pekic, 17.9 / Science Photo Library, 17.11 / UpperCut Images, 17.12 / Chris Tyan, 17.13 / Ditto, 17.6 / Sam Edwards, 17.18 / gerenme, 17.19 / Indeed, Chapter 18 Opener / moodboard, 18.2 / SMH, 18.3 / LWA/Larry Williams, 18.5 / Paul Bradbury, 18.6 / andresr, 18.7 / John Wildgoose, 18.8 / XiXinXing, 18.10 / Susan Trigg, 18.11 / photodisc, 18.12 / Noel Hendrickson, Chapter 19 Opener / Thomas Barwick, 19.3 / GCShutter, 19.4 / Hero Images, 19.5, 19.9 / Phil Boorman, 19.11 / Jetta Productions, 19.12 / Ronnie Kaufman/Larry Kirshowitz, 19.13 / Keith Berson, 19.15 / Robert Daly, 19.16 / Echo, Chapter 20 Opener / Jon Feingersh, 20.2 / Paul Bradbury, 20.3 / Trevor Adeline, 20.4; © McPhersons Wine, 6.9; © Dominos, used with permission / Chapter 5 Opener, 5.1-5.5, 5.8-5.10, Chapter 10 Opener / 10.1, 10.2, 10.4, 10.9, 10.10, 21.1-21.8; Pear285 / Creative Commons CC0 1.0 Universal Public Domain Dedication, 9.4.

Text: '*Why Domino's Pizza?*' Prospective franchisee information booklet © Domino's, used with permission Chapter 10. *'The Communications Council Code of Ethics'* © Communications Council - http://www.communicationscouncil.org.au/downloads_tcc/2013/Code_Of_Ethics.pdf, p.127; *'ACCC Advertising and Selling Guide'* / Creative Commons Attribution 3.0 Australia, p.129; *'Minimum Employment Standards'* / Creative Commons Attribution 3.0 Australia licence, p.332; *'Learning & Developing'* © Optus, used with permission, p.352; *'2013 Absence Management Survey Summary'* © DHS.net.au, p.379; *Share Price and dividends for Dominos Pizza Enterprises Ltd 2012 -2016*, 15.2 / *Dominos geographical segment revenues and results*, 15.3 / *Dominos other revenue*, 15.5 / *Dominos Income tax expense*, 15.7 / *Dominos Consolidated income statement,* 15.8 / *Dominos Consolidated balance sheet,* 15.9 / *Dominos Consolidated statement of cash flows,* 15.10 / *Dominos Short term financing facilities* for 2015-2016, 15.11 / *Dominos Consolidated entity's earings* 2012 -2016, 15.12 / *Dominos Hedging activities*, 2016, 15.14, © Dominos Pizza Enterprises Ltd, used with permission; *'Westpac Employee Benefits Flyer',* © Westpac, p.325.

Every effort has been made to trace and acknowledge copyright. The publisher apologises for any accidental infringement and welcomes information that would redress this situation.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

How to use this resource





Topic and chapter openers

Every **topic** opens with the principal focus and list of outcomes from the syllabus. There is also a short introduction to the topic.

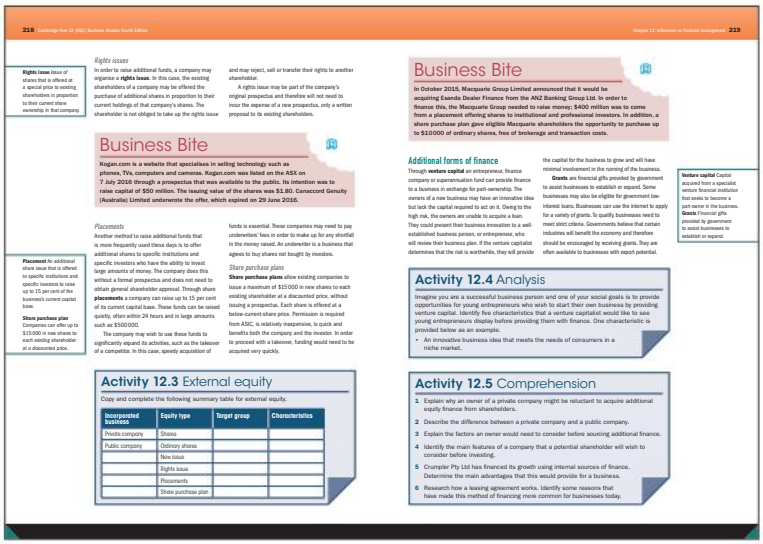
Each **chapter** opens with a list of objectives and key words for the chapter.

Glossary terms

All the key terms in each chapter (along with many more) are defined for you in the margin of the print book, or as pop-ups in the interactive version. They are also gathered in the Glossary at the end of the book.

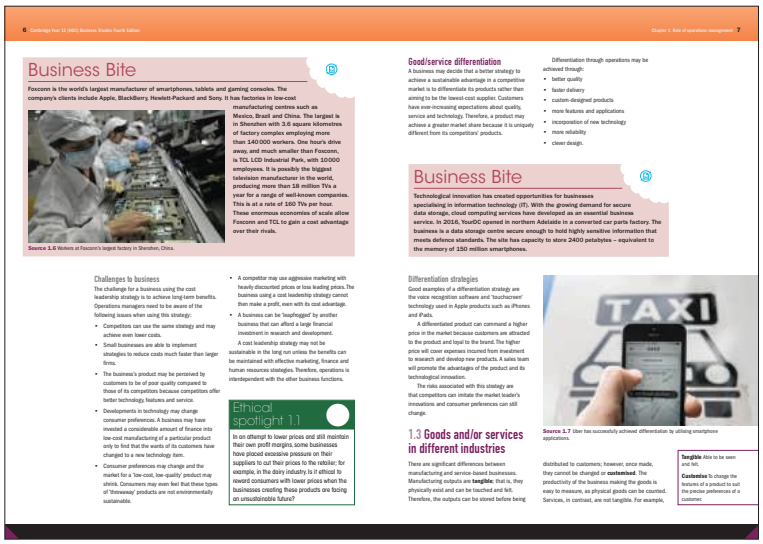
Activities

You can test your understanding and extend your knowledge through a range of activities, including comprehension, discussion, research, analysis and construction.



The update icon lets you know that updated content within this section is available in the Interactive Textbook and in a document downloadable from Cambridge GO.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Business bites

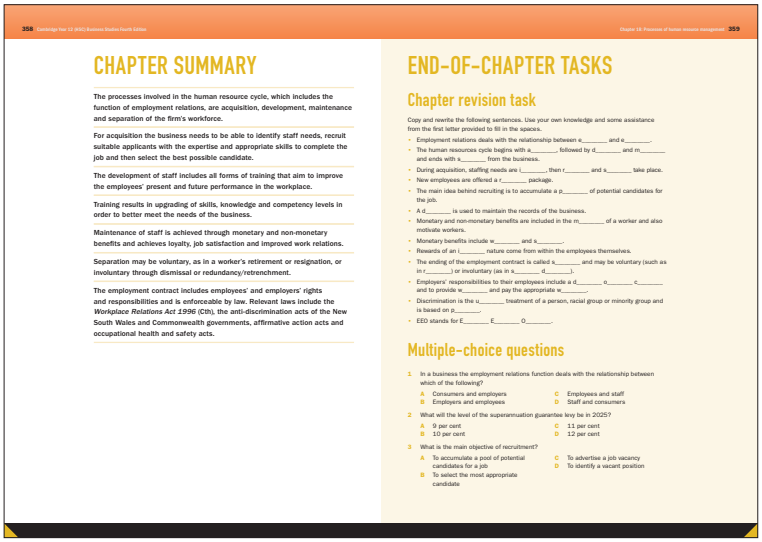
A range of real-world business examples illustrate key concepts and help you understand how they apply.

Ethical spotlights

Opportunities to consider and discuss the ethical considerations of a rapidly changing business environment.

End-of-chapter sections

At the end of each chapter you will find a chapter summary and a set of questions to help you consolidate your learning from the chapter.





Source 2.5 Professor Tim Harcourt of the University of NSW talks about the different types of trade agreements. (02:59)





Video and audio

The interactive textbook contains video and audio items to enrich the learning experience.

Interactive activities

Also included in the interactive textbook are automarked activities (e.g. drag and drop questions) to assist recall of facts and understanding of concepts.

Downloadable Word documents

All activities and end-of-chapter questions are available as downloadable Word documents, which can be accessed from within the interactive textbook or via Cambridge GO.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

CASE STUDY

This textbook contains a whole-year case study on Domino's Pizza Enterprises Limited. At the end of each topic, a chapter is devoted to considering the subjects covered, in the real-world context of Domino's.

ABOUT DOMINO'S PIZZA ENTERPRISES LIMITED

Domino's Pizza Enterprises Limited is an Australian publicly listed company and is affiliated through its branding to the Domino's network worldwide. Domino's Pizza Inc. began in the United States in the 1960s. In 1983, Silvio's Dial a Pizza opened its first store in Springwood, Queensland. In 1993, Silvio's bought the master franchise for Australia and New Zealand from Domino's Pizza Inc. At that time Silvio's Dial a Pizza and Domino's were run separately; however, after 1995 Silvio combined the two businesses and gradually Silvio's stores were rebranded as Domino's Pizza. This pizza business was growing rapidly and was the first to offer a home delivery service.

Source 0.1 Domino's logo



Source 0.2 A Domino's pizza

In 2001, Don Meij and Grant Bourke were the two largest Domino's franchisees in Australia. They merged their 25 franchised stores into a corporate store network in exchange for a share in the equity and profits of Domino's Pizza. Don Meij was appointed the Managing Director of the organisation.

In 2005, Domino's was listed on the Australian Securities Exchange (ASX) and became the first publicly listed Australian pizza company. With the funds generated through the sale of its shares, Domino's expanded internationally and purchased existing Domino's operations in France, Belgium and the Netherlands, and most recently has expanded into Germany. Domino's Pizza Enterprises Limited has the exclusive rights for Domino's Pizza Inc. in these countries. In order to be successful, Domino's planned for a high turnover of a low-priced product.

In 2016, the company rebranded from 'Domino's Pizza' to simply 'Domino's'.

Domino's share price was 66.300 cents per share on 4 November 2016. At the start of the previous financial year (1 July 2015) the price was 36.880 cents – since that time, the highest price was on 18 August 2016, at 80.660 cents.

Today Domino's employs about 1700 people in Australia and about 26 000 worldwide. There are approximately 700 stores in Australia and New Zealand and around 2000 stores worldwide. About 10 per cent of these stores are controlled directly by the company, with the remainder being franchisees.

Pizzas are a popular fast food in Australia. More recently, consumer trends have seen a shift away from the traditional style of pizza towards gourmet and healthier pizza options. The pizza restaurant and takeaway industry has experienced revenue growth of 2.8 per cent over the last five years, with total revenue reaching nearly $3.7 billion in 2016–17.

There are several factors that have influenced this growing trend:

- Developments in technology have increased the efficiency of operations and reflect the demand

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 0.3 Domino's Pizza Enterprises Limited share price for the 18 months from 1 July 2015. (A current graph can be accessed from the Australian Stock Exchange website: find the 'Charting' section and view the chart for DMP.)

for personalised customer orders. Online ordering systems have been developed by the large pizza businesses, with small businesses gaining access to third-party ordering services such as Menulog and EatNow. Domino's receives nearly 60 per cent of its orders online.

- Greater competition in higher-density residential areas has resulted in price competition (especially for traditional-style pizzas).
- Greater variation and differentiation through product offers; for example, coupons/special deals.
- There has been an increasing consumer trend to eat out more frequently.
- In times of greater prosperity and increasing incomes, there is a tendency for increased demand for takeaway food and restaurants.
- A move to healthier food options, with consumer desire for less sugar, salt and fat.
- More TV programs about food may lead to an increased demand for gourmet pizzas at premium prices.

At the beginning of 2016, the pizza fast-food industry was characterised by four main players in the market and many small businesses. Based on IBISWorld data, these were:

- Domino's: 32 per cent of the market
- Pizza Hut: 10.7 per cent
- Crust Gourmet Pizza: 4 per cent
- Eagle Boys: 4.6 per cent.

These four businesses accounted for 45 to 50 per cent of total pizza revenue. In July 2016 Eagle Boys, which was originally the second-largest pizza chain with 340 Australian stores, went into administration in Australia, India and Fiji. (This may provide the remaining pizza organisations such as Domino's with new opportunities for further expansion.)

Domino's has continued to grow, and expanded its Australian and New Zealand network by over 50 stores in 2013–14 and 55 stores in 2014–15. Domino's success has resulted from an increasing focus on:

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- prompt and reliable service
- differentiating its product
- adapting to new technology such as its new software for online facilities
- proximity to its market, which allows for prompt delivery
- flexibility to change its product to better suit its market, reflecting changing consumer tastes and preferences; for example, healthier and better nutrition, and Pizza Mogul so people can design their own pizza.



Source 0.4 Pizza Mogul lets people design their own pizzas, share them on social media and earn money for every pizza sold.

Domino's Pizza Enterprises Limited

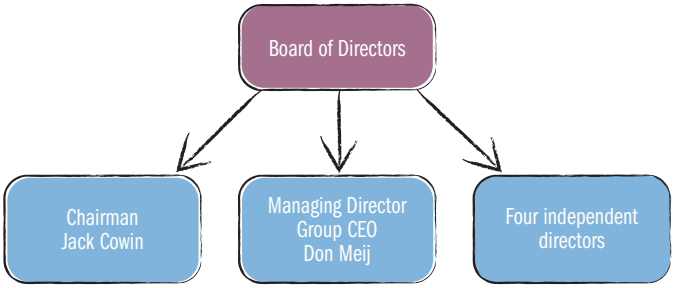
Head Office: Hamilton, Queensland

Website: http://www.dominos.com.au

Mission Statement: 'Sell More Pizza, Have More Fun'

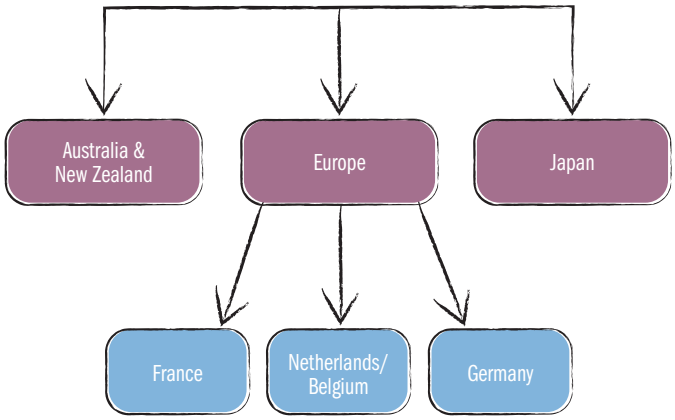
Vision Statement: 'Number 1 in Pizza, Number 1 in People'

Organisational structure



Source 0.5 Domino's Board of Directors

Geographical organisational structure



Source 0.6 The geographical organisational structure of Domino's

Future directions

Domino's continues to grow and plan for the future. The company hopes to have 1200 stores in Australia and New Zealand by 2025. Further developments to support future growth include Domino's automated robotic unit launch of Zero Click ordering to maximise online sales; the development of a new menu, free of preservatives and artificial colourings; and continual increases in store numbers.

Domino's is continually setting up new stores internationally, as well as upgrading its existing stores to be modern and ensure visibility of operations. Domino's scans for and develops leading-edge technology and has developed a culture that actively encourages change to improve efficiency and encompasses total quality management.

Domino's has maintained its competitive advantage and continues to grow.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 0.7 Domino's is continually upgrading its stores to be modern and ensure visibility of operations.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Topic 1

Operations

25% of indicative time

Principal focus

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

Introduction

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 has 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

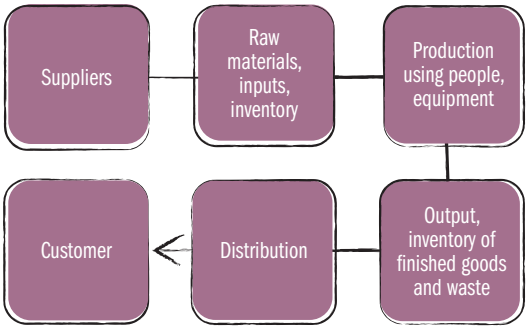
Key terms

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

1.1 Introduction

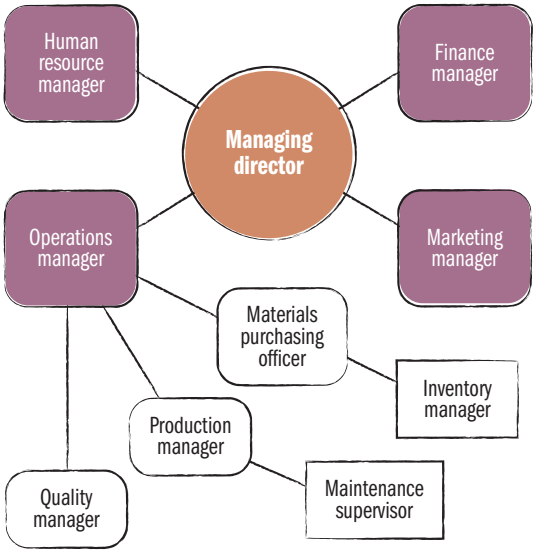
Operations is the business function concerned with the **transformation** of **inputs** into **outputs** (see Source 1.1). The operations manager oversees this process by planning production, organising inputs, monitoring the operations process and controlling the outputs. Outputs can be both physical 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 1.1 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 1.2). In a small business, operations may be managed by an owner, factory manager or sales manager.



Source 1.2 Operations in a functional organisational structure

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- and long-term objectives of the business, primarily profit.

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 The operations manager is responsible for ensuring goods or services are available on time to meet the demand of customers.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

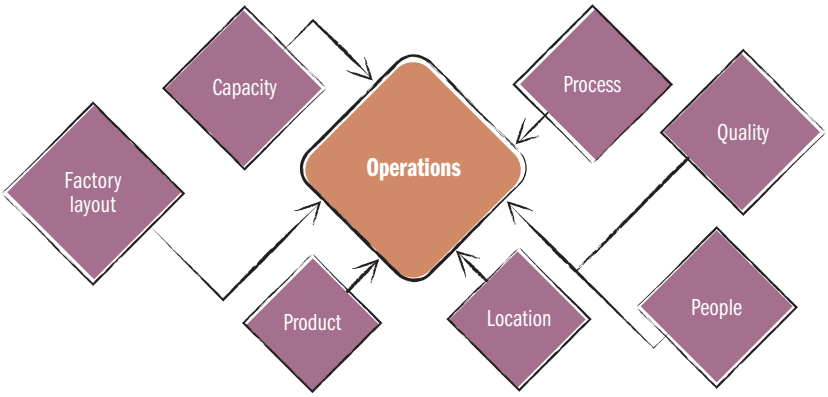
1.2 Strategic role of operations management

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 1.4).

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 1.5).



Source 1.4 Strategic decisions about how operations will be managed

Source 1.5 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?
	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?

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 1.1 Comprehension

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 the 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 Identify skills that the operations managers will need for this position. Explain why these skills are needed.

4 Describe an example of the strategic decision-making that the job requires.

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 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

Foxconn is the world's largest manufacturer of smartphones, tablets and gaming consoles. The company's clients include Apple, BlackBerry, Hewlett-Packard and Sony. It has factories in low-cost manufacturing centres such as Mexico, Brazil and China. The largest is in Shenzhen with 3.6 square kilometres of factory complex employing more than 140 000 workers. One hour's drive away, and much smaller than Foxconn, is TCL LCD Industrial Park, with 10 000 employees. It is possibly the biggest television manufacturer in the world, producing more than 18 million TVs a year for a range of well-known companies. This is at a rate of 160 TVs per hour. These enormous economies of scale allow Foxconn and TCL to gain a cost advantage over their rivals.



Source 1.6 Workers at Foxconn's largest factory in Shenzhen, 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 resources 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?

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 specialising in information technology (IT). With the growing demand for secure data storage, cloud computing services have developed as an essential business service. In 2016, YourDC opened in northern Adelaide in a converted car parts factory. The business is a data storage centre secure enough to hold highly sensitive information that meets defence standards. The site has capacity to store 2400 petabytes – equivalent to the memory of 150 million smartphones.

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 1.7 Uber has successfully achieved differentiation by utilising smartphone applications.

1.3 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,

Tangible Able to be seen and felt.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 1.8 Healthcare professionals provide crucial services for the community.

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.

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 1.9).

Source 1.9 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Source 1.10 Australian industry sectors

Sector	Example	Nature of the goods and services	Industry
Agriculture	Cubbie Station Ltd	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
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
Healthcare	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	Mallesons Stephen Jaques	Ranked in the 100 largest law firms globally, providing commercial legal services	Tertiary
Leisure and gaming	Aristocrat	Supplies slot machines, gaming systems, accessories and services worldwide	Secondary
Manufacturing	CSR Building Materials	Founded in 1885 as the Colonial Sugar Refining Company; now manufacturer of building materials: aluminium, brick, glass and plasterboard	Secondary
Media	Nine Entertainment Co.	Owns Nine Network, Ticketek	Tertiary
Mining and energy	BHP Billiton	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 Group	World's largest listed retail property group; operates a global portfolio of 119 shopping centres in Australia, New Zealand, the United States and the United Kingdom	Tertiary
Retail	Harvey Norman Holdings Ltd	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 600 stores spread across Queensland, New South Wales, Victoria and Western Australia	Tertiary
Telecommunications	Telstra	Formerly a government business enterprise, privatised in 1991, providing landline, mobile and internet services with interests overseas	Quaternary
Tourism	Hamilton Island Enterprises	Leading resort located in the Whitsunday Islands, Great Barrier Reef; 1992 in receivership; relaunched in 2003	Tertiary
Transport and logistics	Qantas	Provides transport through its two-brand strategy, Qantas and Jetstar; air freight services are also offered	Tertiary

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 1.2 Comprehension

1 Identify the range of services provided in the tourism industry.

2 Outline the mix of goods and services provided in the hospitality industry.

3 Describe the differences in the nature of service-based businesses and those that produce goods.

4 Explain how a beverage manufacturing business can achieve product differentiation through operations.

5 Analyse the importance of technology when providing services in the healthcare industry.

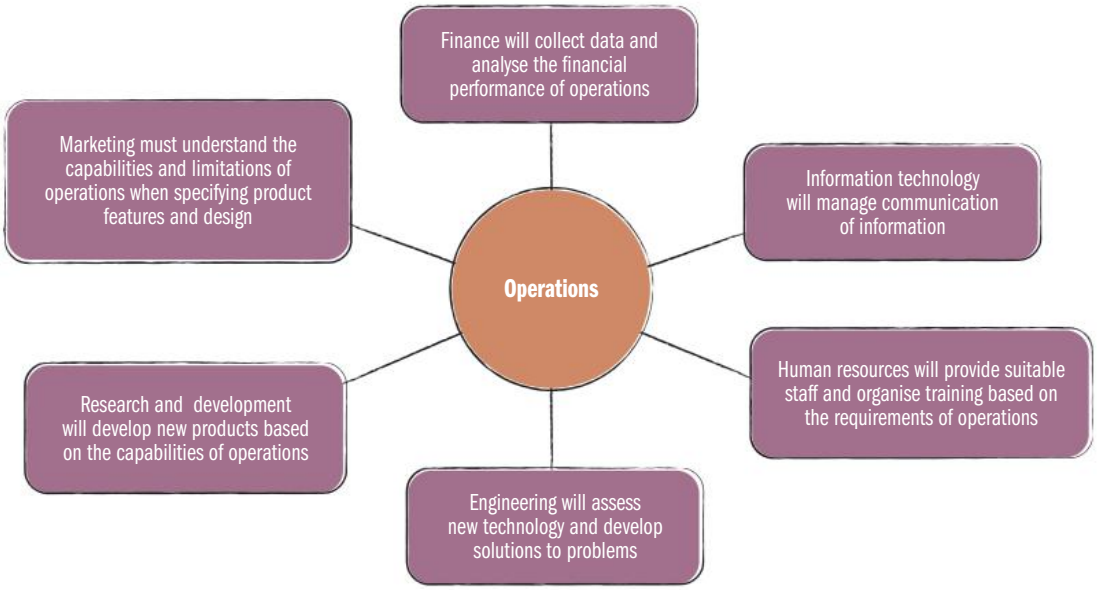
1.4 Interdependence with other key business functions

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.

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 other so that the business can achieve its goals. Therefore, with **specialisation** of the business functions there must be **interdependence**. See Source 1.11.

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

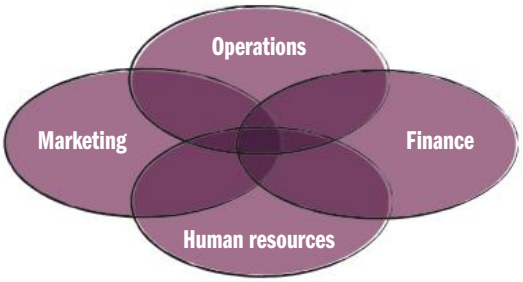


Source 1.11 The interdependence between operations and other business functions

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

needed. The human resources manager will use their leadership style and rewards to ensure quality work is done by employees in the operations function.

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 1.12 The interdependence between the key business functions



Source 1.13 Changes to operations can greatly impact a business, such as the need to retrain staff.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

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

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 What is an output of a service-based business?

A Experienced and helpful staff
B Final goods ready for sale
C Social responsibility
D Satisfied customers

3 Which of the following is a strategic decision of the operations function?

A Reducing the amount of waste by 10 per cent over six months
B Forecasting the amount of inputs required for production
C Organising repairs to a breakdown in the assembly line
D Relocating the business in five years

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 What is a financial benefit of a product differentiation strategy?

A Increase in revenue
B Reduction in operational costs
C Highly specialised and skilled employees
D Improved quality

7 Which of the following is an example of a strategic operations decision?

A Organising the working roster
B Having repairs made to equipment
C Making long-term plans to update equipment
D Ordering inputs from an overseas supplier

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

10 Which management skill is most important when coordinating the key business functions with the operations function?

A Communication skills
B Interpersonal skills
C High ethical standards
D Flexibility and adaptability to change

Short-answer questions

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

2 Examine why communication between operations and the other key business functions is a critical success factor for a business.

Extended-response question

Outline the strategic role of operations and analyse the impact of a cost leadership strategy on a business. Refer to a business case study in your answer.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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
- trading bloc



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

2.1 Introduction

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.

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.



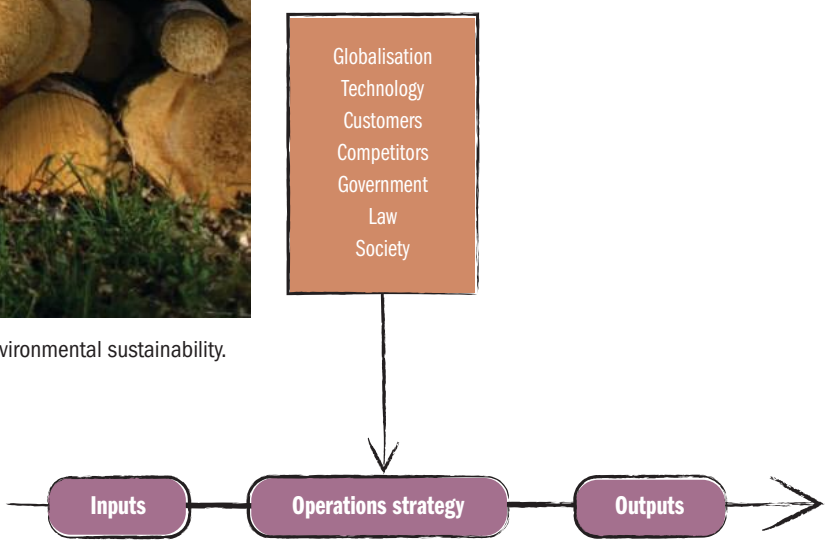
Source 2.1 Business is influenced by many factors, including environmental sustainability.

2.2 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.

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.



Source 2.2 External influences on operations

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 2.3.

Source 2.3 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 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.

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.



Source 2.4 Depreciation of the Australian dollar will lead to rising costs.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 which exports parts to be put into the toys. Transactions are always in US dollars to reduce currency exchange risk.

Trade agreements

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 the European Union and the North American Free Trade Agreement (Mexico, United States and Canada). 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.

Source 2.5 The European Union is a regional trading bloc.



Ethical spotlight 2.1

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

Activity 2.0

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

In recent years, Australia has signed a number of trade agreements as the government tries to access growing markets in Asia. Australia's top three trading partners are China, Japan and the United States. In 2014 the Korea-Australia Free Trade Agreement (KAFTA) came into force and in 2015 Australia entered agreements with both China and Japan – the China-Australia Free Trade Agreement (ChAFTA) and the Japan-Australia Economic Partnership Agreement (JAEPA). Other advantages for Australia include more competitive exports, increased two-way investment and reduced import costs for Australian consumers and businesses. Interestingly, while many nations are forming trade agreements, Britain voted in a referendum in June of 2016 to leave the European Union, and the new US president, Donald Trump, has decided against participating in the Trans-Pacific Partnership.

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.

Business Bite

UGG Australia is a brand that has found a global market. The sheepskin boot, developed in Australia, has had many manufacturers and sellers. The brand Ugg Australia is now owned by Deckers, an American footwear company, with boots manufactured in China.

Activity 2.1 Comprehension

1. Define the term 'integration' with reference to globalisation.
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. Explain why an Australian exporting business would use a product differentiation strategy in its operations.
5. Analyse the impact of trading blocs on the operations of an Australian manufacturing business seeking to expand as part of its strategic plan.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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, in 2010 the Indian organisers of the Commonwealth Games came under much criticism for their approach to the operation of delivering a well-resourced and organised event. While Japan is famous for its just-in-time approach to efficiency, the Indian way of doing things is termed **Jugaad** in time. This short-term improvised approach to organising operations was very frustrating for foreign firms and governments, as their accepted approach was to use clear scheduling and sequencing, and a high level of quality control with plenty of time for product testing and review.

Jugaad 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.

In the Jugaad approach, forecasting, planning, operations strategy, project management and checking are considered wasteful and not value adding. Overseas businesses and governments involved in the Commonwealth Games had to trust that, given enough manpower, everything would be complete in the moments before the event began.

2.3 Technology

Globalisation has spread technological developments worldwide. Products of technology such as mobile phones, email, smartphones and the internet are drivers of globalisation, enabling service-based businesses to penetrate global markets with the international distribution of information. 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.

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.

Business Bite

Airbnb allows people around the world to list rooms or residences to be booked for short-stay accommodation. It was established in 2008 as AirBed & Breakfast by two roommates: to help pay the rent on their apartment, they set up airbeds in their lounge room and advertised the accommodation, along with a home-cooked breakfast. Since then, Airbnb has grown to over two million listings in more than 30 000 cities, in 191 countries worldwide. Over 60 million people have spent a night in an apartment, house or even castle booked through Airbnb. Social media is a key element of the company's extraordinary global success. Through word of mouth online, Airbnb has become a travel phenomenon. The service encourages its growing community of users to monetise their extra space. Airbnb then connects travellers on any budget to unique experiences, while prioritising friendly customer service. Overall, Airbnb is an online business that owes its rise to the advent of social media, developments in technology and globalisation.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 is a challenge for management to maintain effectiveness and efficiency in operations.



Source 2.6 New technologies have rapidly transformed some of the work performed in service-based businesses such as supermarkets.

Source 2.7 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 with 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.

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 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'.

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

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.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

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

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 'business-based' intranets 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 resources 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.

Business Bite



Technological innovation has brought CAD and CAM into the home. 3D printers and computer software have made it possible to scan, design and create complex shapes in a hard plastic material. The technical term is additive manufacturing (AM). The MakerBot Replicator Mini is available from Officeworks for less than $3000. 3D printing has benefited small manufacturing, and engineering businesses can now access relatively inexpensive 3D technology to develop new products much faster. Small models of complex products can be created with CAD and 3D printing to check design and eliminate flaws before the final product is created in operations.

Source 2.8 3D printers can be used to create products more efficiently.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 2.2
Research and comprehension

1 Outline the advantages of using technology in farming.

2 Describe the impact of technology on the human resources function of a business.

3 Explain the relationship between CAD and CAM.

4 Analyse the impact of technology on a business's ability to use a cost leadership strategy to obtain a competitive advantage.

2.4 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:

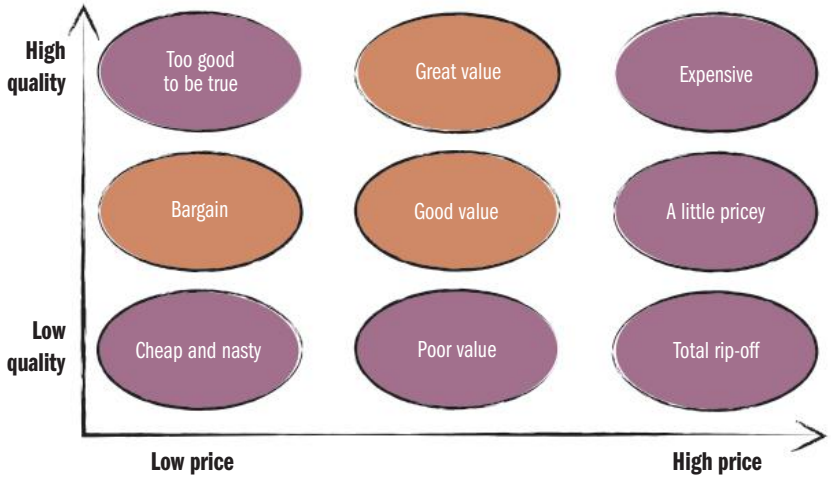
- durability – how long the product lasts given a reasonable amount of use
- reliability – how long the product functions without needing maintenance or repairs
- fitness for purpose – how well the good or service actually matches all the claims of the advertising.

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 do 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 2.9).

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.

2.5 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



Source 2.9 How customers perceive quality and price

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Retailer JB Hi-Fi is known for its cost leadership in the technology market in Australia.

2.6 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. The change in federal government following the 2013 election has had significant impacts on climate change policy and, in particular, the carbon tax. This tax had been imposed on the top 500 polluters in Australia so that they would change their operations and invest in pollution-reducing technology. In 2014, the Liberal government replaced this tax with its Direct Action Plan. This policy provides payments from the Emissions Reduction Fund to polluters who reduce their emissions. This policy was maintained in the 2016–17 Budget.

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.



Source 2.11 The Australian government organisation Austrade provides Australian companies with free general information about exporting and conducting business in international markets.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

2.7 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.

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.

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

Business Bite

The federal government's National Innovation and Science Agenda was announced in 2015. This initiative aims to encourage and support innovation in every sector of the economy. From 2016, $1.1 billion is to be invested into 24 initiatives over four years. For example, the Innovation Connections program will make money available so that small- and medium-sized businesses can employ graduate and postgraduate researchers, and for business researchers to work in government-funded research organisations such as the CSIRO (Commonwealth Scientific and Industrial Research Organisation). From these collaborations new ideas can be turned into new commercial products. Australian businesses can create employment, become more competitive, develop and export their products, and thus contribute to economic growth.



Source 2.12 Innovation Australia invests in innovations like cleaner fuel sources.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 business 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 or packaging rules. • Information – labels must include all relevant information such as country of manufacture or ingredients.

Activity 2.3
Comprehension and discussion

1 Outline an example of a workplace safety policy or procedures that could be used in an office.

2 Describe the impact of the *Competition and Consumer Act 2010* (Cth) on the operations of a business making children's toys.

3 Account for increasing regulations for environmental protection in Australia.

4 Explain why an operations manager must be aware of all relevant laws and regulations.

5 Discuss the impact of rigorous government safety regulations on the operations function of a manufacturing firm.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

2.8 Environmental sustainability

Ecological 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.

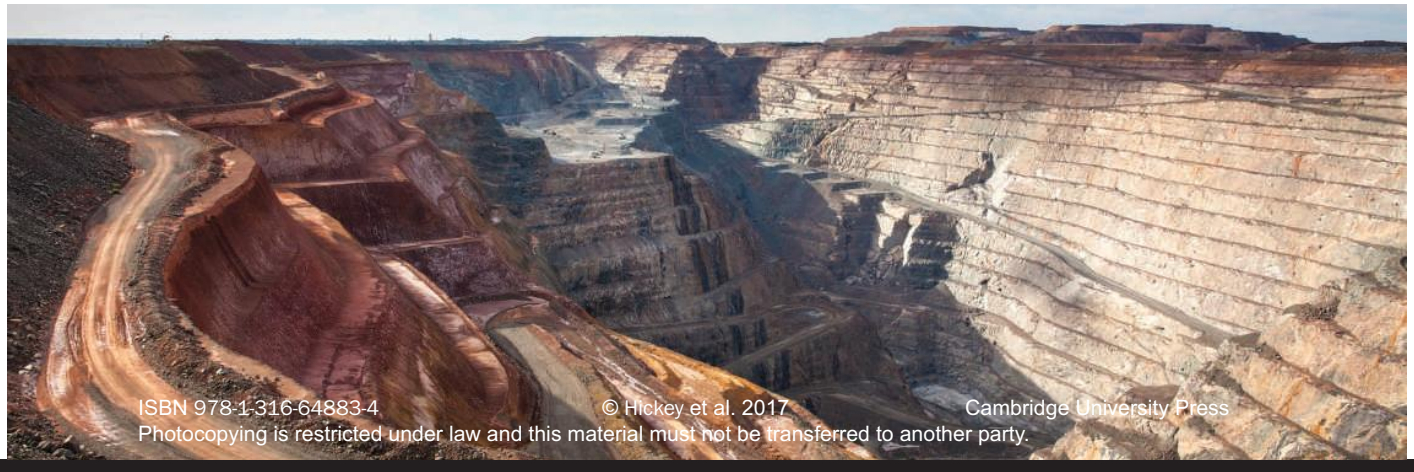
Business Bite

TerraCycle is a private company in the waste management industry founded by Tom Szaky in the United States. The business's first product was a liquid fertiliser generated from organic waste, sold in recycled plastic bottles and soft drink cans. The business moved away from manufacturing and focused its efforts on developing innovative recycling solutions for difficult products; for example, cigarette butts and juice boxes. TerraCycle can collect and recycle any form of waste. As well as selling recycled and upcycled products, TerraCycle also works with other businesses to develop recycling programs and create useable products from waste. For example, plastic pellets created from waste plastics can be transformed into flower pots and plastic pavers. All waste is recyclable and therefore custom-designed solutions are this business's point of difference. TerraCycle's head office has been the subject of a reality TV series called *Human Resources*. The company now operates in 26 countries including Australia.

TERRACYCLE®

Source 2.14 TerraCycle is a company that focuses on recycling difficult forms of waste.
Source: www.terracycle.com.au

Source 2.15 Australia's largest open-cut gold mine, in Kalgoorlie



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

2.9 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.

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.

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 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

Chevron, the American oil company, first appeared in Western Australia in 1952. Significant discoveries of natural resources were made in the 1960s and 1970s. Chevron is now one of the world's largest suppliers of liquefied natural gas. In 1967 a 10 million tonne per annum gas project was approved for Barrow Island by the federal government. As part of its commitment to corporate social responsibility and strict environmental conditions set by the Western Australian government, Chevron Australia has managed its environment impacts on Barrow Island since 1967. Dr Harry Butler, the famous Australian naturalist, has been a consultant with Chevron since Barrow Island operations started. Dr Butler is still a special consultant for Chevron Australia, ensuring that environmental management programs protect the biodiversity of species on the island. The company has already committed $62.5 million to the North West Shelf Flatback Sea Turtle Conservation Program. This decision underlies Chevron's philosophy that industry and environment can coexist.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 2.4 Discussion

1. The law should be changed to make company directors criminally responsible if a business does something that is illegal. Discuss.
2. Businesses have a responsibility to their shareholders and owners before other stakeholders. Discuss.
3. Corporate social responsibility practices are marketing strategies. Discuss.

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 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



Source 2.16 Support of charities and community organisations may be outlined in a business's code of conduct.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 pay their membership each month they use the centre. The language of contracts too 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.

Ethical spotlight 2.2

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

Environmental sustainability and social responsibility

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

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.

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 its commitment to the conservation of fresh water.
- Cue, the fashion brand, continues to manufacture almost all of its products in Australia, keeping jobs in Australia. Cue is accredited with Ethical Clothing Australia.
- 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Government policies encourage businesses in Australia to be more competitive through cost-efficient operations, ecologically 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

Copy and complete the following passage by selecting the most appropriate word in this table for each space.

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 resources and the operations function will need to be aware of _____ influences that affect the way people work, make decisions and organise operations.

Multiple-choice questions

1 Which of the following statements best defines the term 'globalisation'?

A Globalisation is the rapidly expanding world population and economic growth.

B Globalisation is the growth of developing countries and their trade with the rest of the world.

C Globalisation is the integration of the economies of different countries to create a global economy.

D Globalisation is the growth and expansion of global businesses, consumers and rapid technological change.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

3 How would resource availability influence business operations?

A The location of manufacturing can change.
B Finished products can be distributed to new markets.
C Access to low-cost labour can reduce costs.
D Profit on the sale of finished goods is reduced.

4 What are the main components of CAD and CAM technology?

A Computers and software
B Information, technological knowledge and skill
C Assembly lines and factories
D Employees and employers

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.

9 Which of the following is a financial reason why a business may implement socially responsible decisions?

A Profitability
B To attract and keep good staff
C To increase sales
D To reduce operations costs

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Short-answer questions

1 Outline the impacts of globalisation on the operations function of an Australian business.

2 Describe how a business would change operations to be more environmentally sustainable.

3 Explain the objectives of business regulation.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

3.1 Introduction

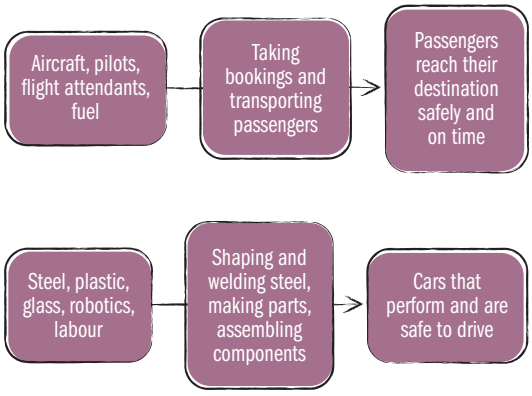
Operations processes are the activities involved in the transformation of inputs into outputs. These may also be referred to as the production system or operations system. Each activity adds value so that the output has a greater value than the cost of inputs. The outputs will be sold for a profit.

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 which 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.



Source 3.1 Transforming inputs into outputs – operations for different products: an airline and an automotive factory

3.2 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 3.2 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, at school the inputs are the classrooms, students, textbooks, computers and teachers. The transformations that occur involve educating and socialising students, and the outputs are knowledgeable students who can learn new skills quickly as productive citizens ready for the workforce. Some inputs are transformed resources and others are transforming resources; that is, the transforming resources are responsible for changing the transformed resources.



Source 3.3 Inputs at school include students, teachers, classrooms and computers.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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

Fuel represents approximately a third of the input costs for airlines. An A380 requires 320 000 litres of fuel for a flight from Sydney to Los Angeles. At a price of $0.77 per litre the cost rounds out to $250 000 to accommodate 14 first-class, 64 business, 35 premium economy and 371 economy passengers. Including $12 625 in staff pay and $11 414 in food and drink, total costs for the flight are just over $305 000 (USD). A380s have been used by Qantas since 2009 owing to their superior fuel efficiency and lower airborne costs. A Boeing 747-400 costs approximately 12 per cent more per passenger kilometre to keep in the air.

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. 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.



Source 3.4 Business managers must understand the key information relevant to their operations. In some workplaces, this information is presented in the form of analysis reports.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 resources 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.

Activity 3.1 Comprehension

Identify the transformed and the transforming resources used to provide a restaurant meal, a theatre performance and a car.

Source 3.5 Employees can be a business's greatest asset.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Source 3.6 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

3.3 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 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 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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 3.7 Bakeries produce different breads using the same process in large batches.

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 breads, 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 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.

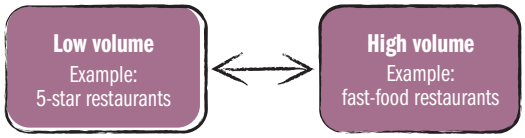
Volume

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

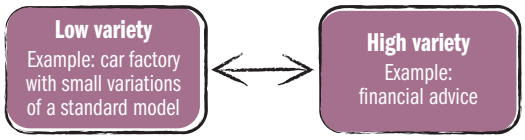


Source 3.8 Volume of production can differ significantly between different types of businesses within a particular industry.

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.

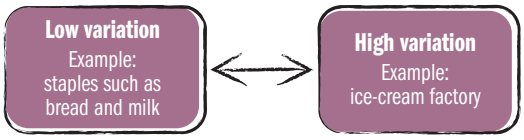
Therefore, the influence on the operations process will be similar to the influence of volume. A business producing a high-volume product with low variety will be capital-intensive, with assembly lines and a focus on producing at the lowest costs per unit possible.



Source 3.9 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.

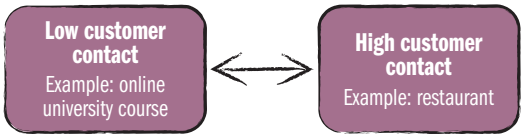


Source 3.10 Variation in levels of demand for a product or service will influence a business's operations.

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.

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 resources function will be essential. Speed of operations will also be important, as customers usually have a much lower tolerance for waiting. So short time lags between customer ordering and delivery will be needed; otherwise, the customer may change to a competitor.



Source 3.11 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

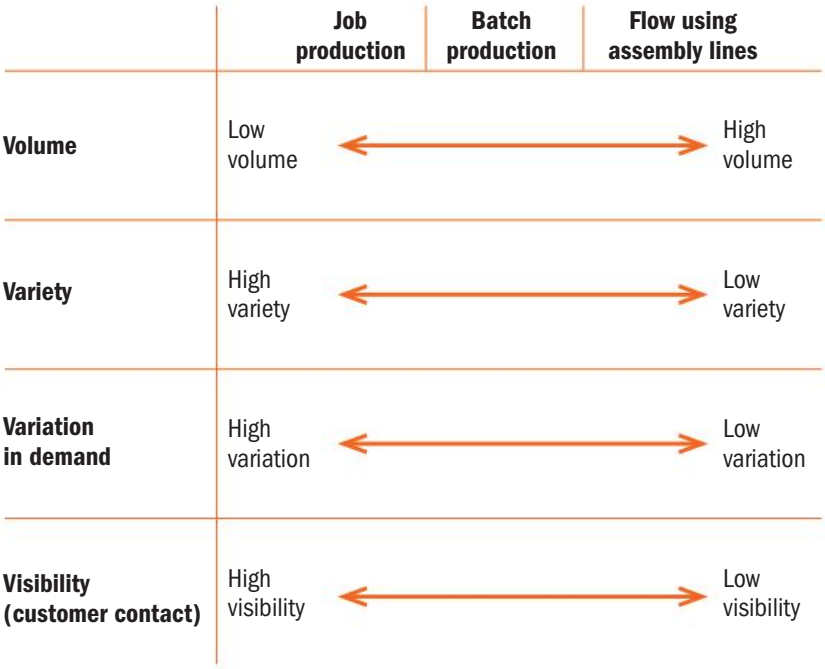
a high level of personal customer contact is no longer always necessary to make the sale.

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 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.



Source 3.12 Influence of the four Vs on operations

Activity 3.2

Copy Source 3.12 and indicate on the diagram the influence of the four Vs for the following operations:

1 car assembly factory

2 takeaway pizza shop.

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. In 2014 McDonald's introduced a degree of customisation, and therefore job production, with the Create Your Taste initiative. Customers could design their own gourmet burger in six steps via a self-serve kiosk. This initiative aimed to appeal to an additional target market, the discerning diner.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Gantt charts

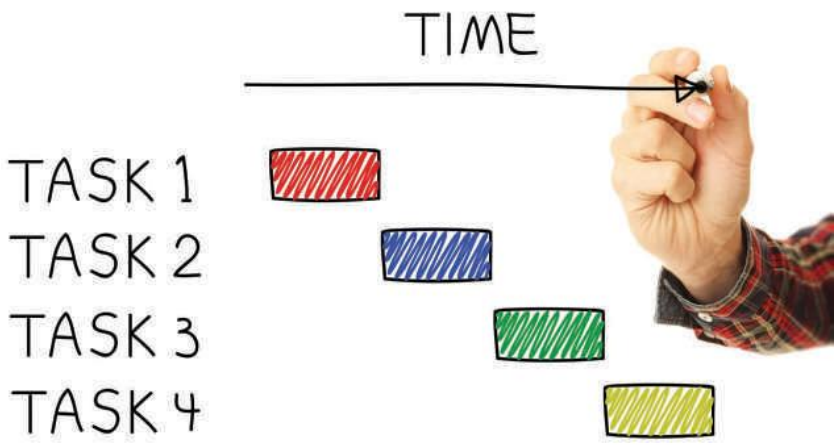
One of the most common scheduling techniques is the **Gantt chart**. A Gantt chart records the number of tasks involved in each particular project and the estimated time needed for each task. The business can set specific dates for the completion of each stage of operations.

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.

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

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.



Source 3.13 Scheduling and sequencing tools such as Gantt charts help businesses to plan complex projects with multiple interrelated parts.

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						

Source 3.14 A simple Gantt chart, in which production is based on customer orders.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 3.3 Construction

Construct a Gantt chart based on the following passage.

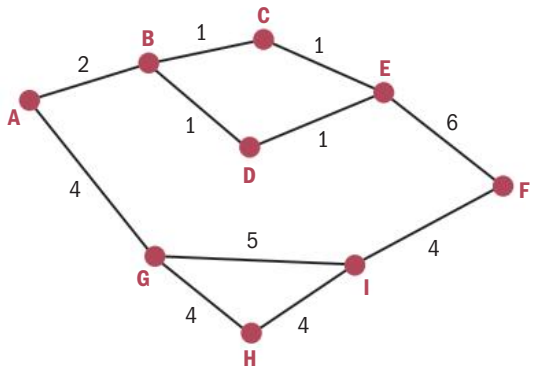
Building a house is a project that requires careful planning; otherwise expensive mistakes can be made, such as having to remove a concrete floor to install plumbing. Task analysis has indicated that there are many different tasks that must be performed and that some can occur at the same time as others. First, the architect must finish the design and plans for the builder. This takes a total of four weeks. Once all the approvals have been granted (taking two weeks), the foundations can be laid. While the foundations are being finished (1 week), the builder will order all the necessary materials for building the house (1 week). Before the bricklayers begin, the plumber installs all the taps, pipes and outlets that are needed (2 days). The work of bricklayers, carpenters and electricians takes four weeks. Once their work has finished, the plumber will finish installing the bathroom and kitchen fittings, which only takes three days. The house will then be painted and carpeted (2-3 days for each). Painting occurs before the carpets are laid so that they are not damaged. After a final inspection the project manager may have some minor corrections or work to finish (1 week) and then the house is ready.

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.

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.

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 3.15, 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 3.15 A critical path analysis.
Note: each number indicates how many weeks it takes to complete each stage or task.

Note: in Source 3.15, 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 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 proven in operations without the risk of investing in a new technology that may fail.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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**.

Even the most labour-intensive industries use process technology. For example, a local organic farmers' market may use wireless EFTPOS 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 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.

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

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. 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.

Task design Deciding how a task will be completed.

Source 3.16 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.



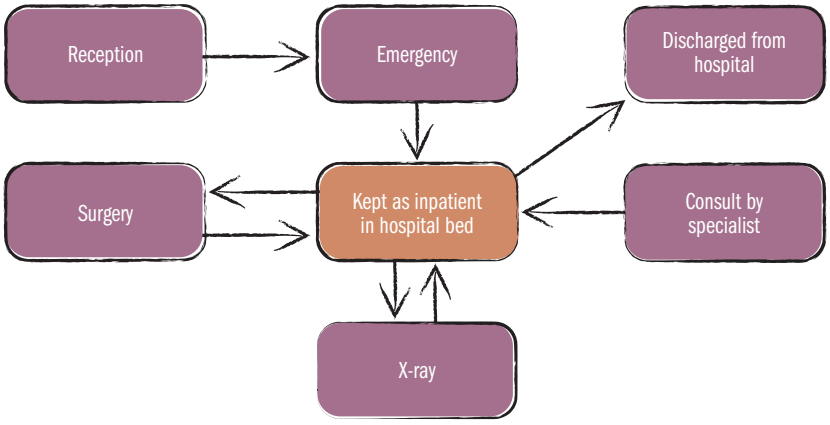
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Process layout

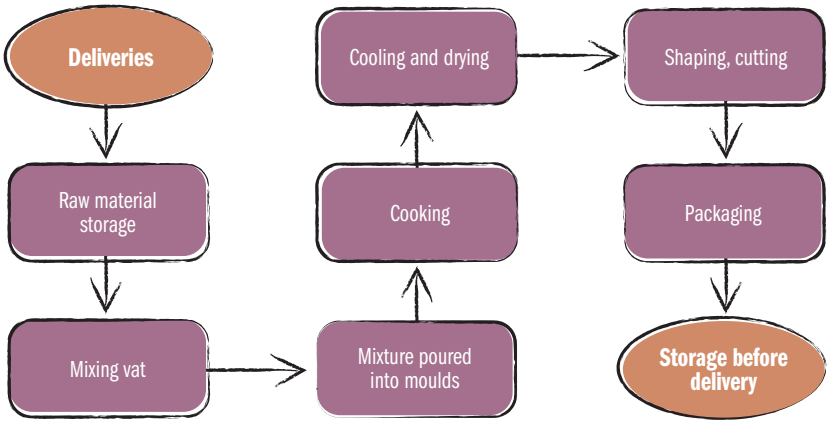
Once the task has been analysed and the technology requirements determined, the next strategic decision is to plan the physical layout of the business's factory or office. This is called facilities layout planning. Layout will also be influenced by the size of equipment, work areas and storage space.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



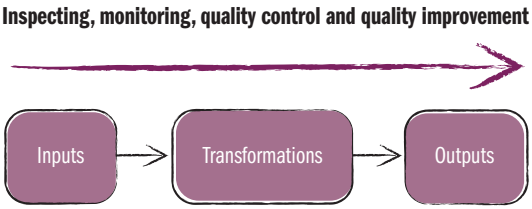
Source 3.17 Process layout diagram for a patient in a hospital



Source 3.18 Product layout diagram for a food manufacturer

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 3.19 as they occur at each stage of the operations process.



Source 3.19 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

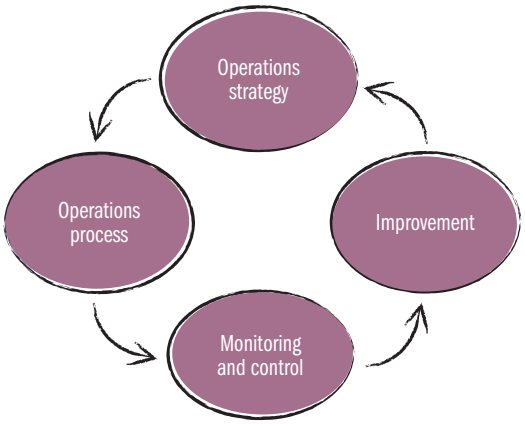
Key questions that must be answered by the manager are whether the current operations are satisfactory and where improvements can be made.

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.



Source 3.20 Key performance indicator (KPI) reports are used by businesses to monitor operations and judge how the business is performing.



Source 3.21 Monitoring, controlling and improving process

Business Bite

The car market in Australia is highly competitive, such that companies aim to reduce costs as much as possible. A number of Chinese manufacturers have entered the budget end of the market. Great Wall made a grand entry in 2009, while small numbers of Chery, Foton and Geely have also sold in the Australian car market. Haval had a $20 000 urban SUV for sale in 2015, although the Australian market was a small part of Haval, which was selling more than 1 million cars worldwide. These companies focus on manufacturing large volumes of vehicles to minimise the average cost per vehicle (economies of scale). Offering a limited variety of models also assists with this cost leadership strategy. However, this strategy has not been successful in Australia. At its peak in 2012, Chinese brands sold only 12 000 individual cars in Australia. This is despite their relatively low price compared to US, Japanese and European brands. Feedback and market research indicated that potential Australian customers have doubts about the quality, reliability and safety of these imported brands. Product recalls of 2000 Great Wall vehicles in 2012 and poor crash test results have significantly impacted on the brand value of Chinese-manufactured cars.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

3.4 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 3.22 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 good customer service

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

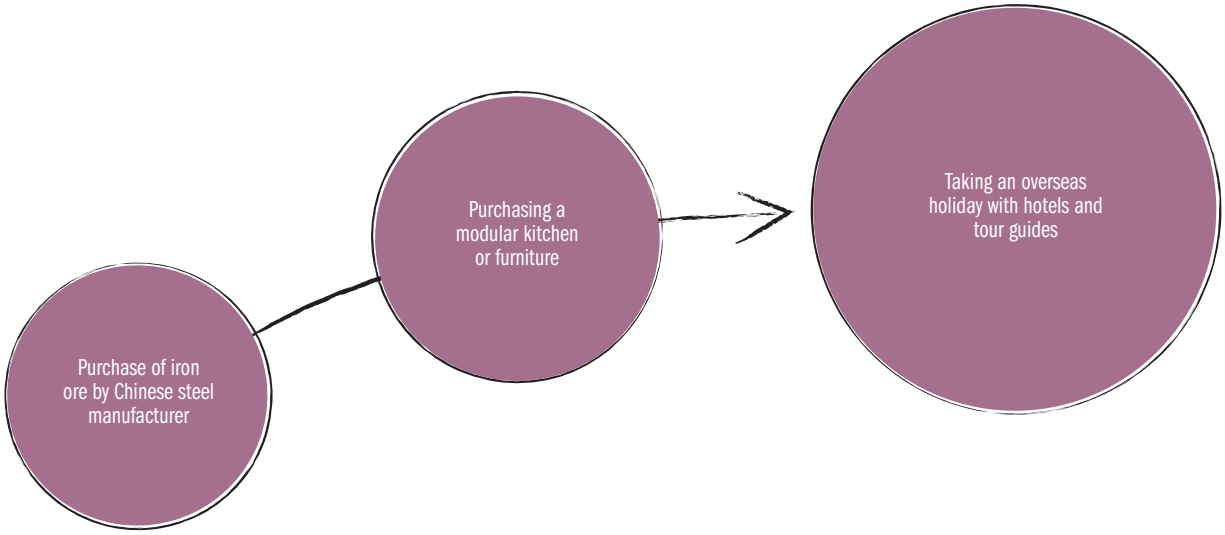
is that customers buy and keep returning. It assists in maintaining the 80/20 relationship; that is, 80 per cent of revenue comes from 20 per cent of the customer base who return to the business. If a business can combine excellent customer service with a high-quality good, then it can command a premium 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 its other 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.



Source 3.23 Instagram can be used for 24-hour customer service.



Source 3.24 The increasing degree of service provided in different industries

Business Bite

Telstra is committed to providing telecommunication services to its customers in a way that ensures a 'personalised, seamless experience that makes it easier for them to manage their lives'. Telstra offers 24/7 support for its products and can be contacted in a variety of ways – by phone or email, in writing or in person. Telstra also offers multicultural call centres and translation services for non-English-speaking customers. Information about products and services within Telstra are accessible for all people – with plain English options, a Disability Equipment Program and an Access for Everyone scheme designed to help low-income individuals meet their telecommunication needs. Telstra commits to the safety and security of all customers, a flexible and fair payment system as well as a dedication to diligently tend to any concerns or complaints by customers.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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 *Fair Trading Act 1987* (NSW) and the *Competition and Consumer 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.

Activity 3.4 Analysis

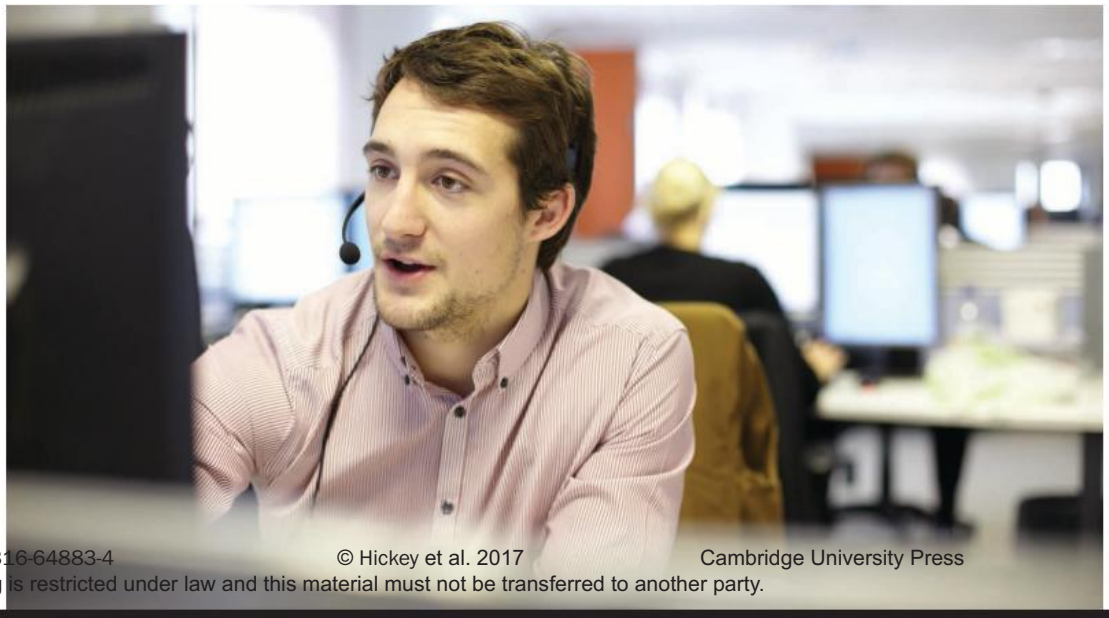
1 Outline the services that accompany the following products:
   - **a** a restaurant meal
   - **b** a new car
   - **c** a business that supplies indoor plants for decoration to office buildings.

2 Describe the benefits to a business of faster response times to customer enquiries.

3 Explain why it can be difficult to achieve an increase in productivity for the delivery of a service.

4 Evaluate the importance of customer service to a business that supplies components to other manufacturing businesses.

Source 3.25 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.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision tasks

1 Match the following outputs with the appropriate businesses.

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

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Which of the following is NOT a benefit from the introduction of technology to operations?

A Reductions in waste and improvements in efficiency
B Introduction of new and better products
C Industrial relations issues
D Improved communication

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

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 When do improvements in process technology occur?

A When a business seeks a competitive advantage through lower costs
B When a new invention leads to a new product
C When a business learns from its mistakes
D When a business applies technological innovation to the operations process

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Short-answer questions

1 Identify the difference between a transforming resource and a transformed resource.

2 Outline the difference between Gantt charts and critical path analysis.

3 Describe the difference between monitoring and control strategies.

4 Explain how task design can give a business a competitive advantage.

5 Assess the importance of continuous improvements in customer service.

Extended-response question

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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
- global web strategy
- inventory
- lead time
- liquidity
- obsolescence
- patent
- productive capacity
- quality assurance
- quality circles
- quality control
- restraining force
- stock-out
- technology
- total quality management (TQM)
- transport logistics
- vertically integrate
- world's best practice



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

4.1 Introduction

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 resources functions. An effective operations strategy will give a business a competitive advantage.



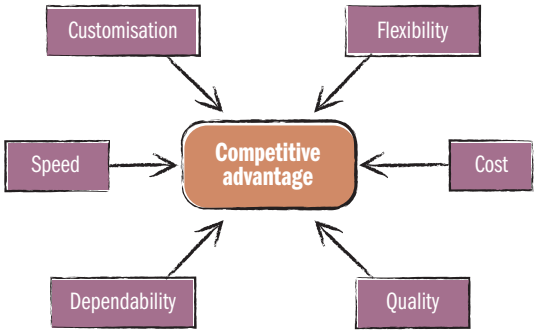
Source 4.1 Operations strategies support a business's strategic goals and must be coordinated with other functions across the business.

4.2 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.



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 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-sale 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 car manufacturer aims to achieve an output of 15 000 finished cars in 30 days. The factory 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 manufacture (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 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.

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.

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.

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



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

Industrialised pasta products have been present on supermarket shelves for decades. A staple in most households, companies such as Barilla and San Remo have solidified themselves as the top bulk pasta manufacturers in Australia. From milling to packaging, the pasta production process is done entirely through the use of various machinery. After the process of durum wheat milling, semolina is mixed with water and egg to form a dough, which is then sent through an extruder. The dough is manipulated into various shapes and then dried in order to be ready for packaging and increase the life of the product. Vegetable dye can also be used to produce coloured products. A pasta manufacturing machine can produce upwards of 300 kilograms of pasta in one hour.

Productive capacity The maximum potential output of a business.

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

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 demand for the business's products in the market. 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.

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,

Business Bite

Building aircraft requires the highest level of quality to ensure that they are a safe, air-worthy product. Learjet is a well-known name in the aviation industry as a manufacturer of jets for the corporate market. The original Learjet design was based on a Swiss military aircraft which was modified with a number of unique innovations to make it suitable for wealthy individuals who wanted their own private jet. Today, this company still manufactures in the United States to the highest-quality standards. Compared to Boeing and Airbus, Learjet is a low-volume producer. Variation in demand is relatively low as Learjet is the market leader in a small market, and therefore there is a steady backlog of orders to fill. At any one time there are several planes at different stages of production. The production process has features of individual jobs and continuous flow. Variety is limited because there are only two models: the Learjet 70 and the Learjet 75, which can be modified to carry between seven and nine passengers. However, there are an infinite number of cosmetic variations as clients can customise every aspect of the interior from seat covers, carpets, panelling and entertainment systems to painting the outside as the client desires. Although the visibility of operations is low, clients are offered a factory tour during production to see their personal aircraft as a work in progress. This reinforces the high standard of quality for building, unique innovations and attention to detail from employees on the factory floor. One of the final quality tests is to ensure the plane can withstand a bird-strike in the air. To assess this, dead chickens are fired at the windscreen!



Source 4.4 Learjet offers modifiable service with its customisable corporate jets.

ISBN 978-1-316-64883-4
© Hickey et al. 2017
Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 costs, 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.

Costs can also be:

- direct – are 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.



Source 4.6 The salaries of administration staff can be considered an indirect cost.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

Activity 4.2
Comprehension and analysis

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.

4.3 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

Business Bite

Apple Inc. is an example of a business with the ability to achieve a long-term competitive advantage in computing, smartphones and tablet devices. The company has a well-organised system of research, technical knowledge and innovation combined with the ability to translate these into commercial products that have been the 'first to market' and become the market leaders, at least initially. The first Apple iPad sold 1 million units within 28 days of its release in 2010.

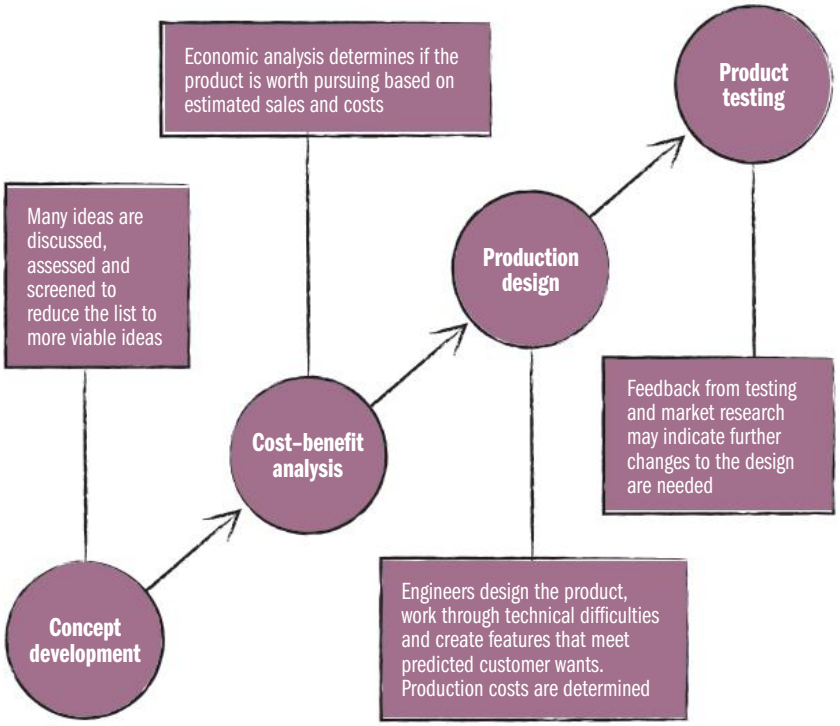
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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:

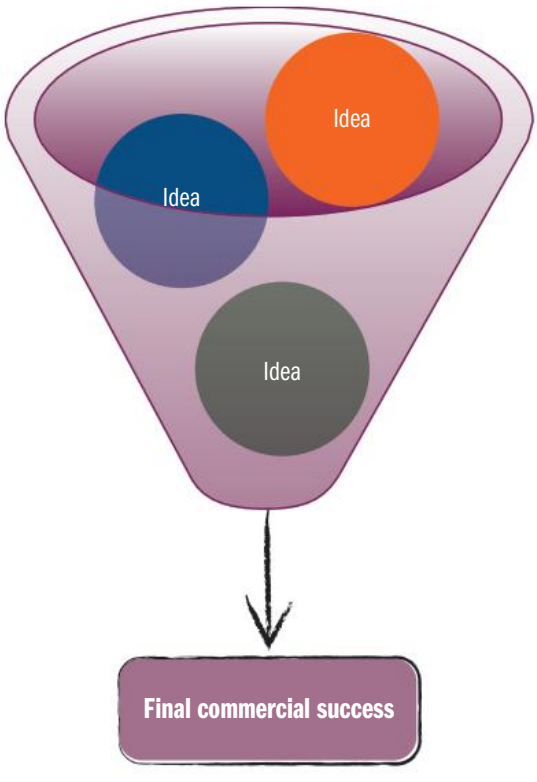
- too expensive to make – a financial filter
- beyond the capabilities of operations to make – a capability filter
- having problems with design – a technical filter
- not going to be received well in the market – a commercial filter.

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 the advantage from 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 4.8 New product development process



Source 4.9 Idea elimination funnel

4.4 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 until the delivery of those goods to the purchaser. Both manufacturing and service businesses need to have

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

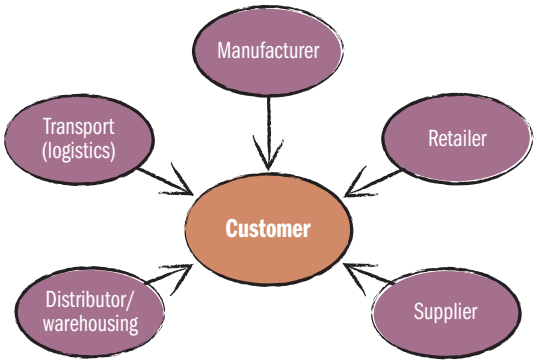


Source 4.10 Suppliers need to know quantity, transport facilities and expected delivery times.

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 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. Thus 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.



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

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 IT 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 in 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

With its population centres separated by vast distances, road transport of freight is an important part of economic life for Australia. Albert Toll founded one of Australia's largest transport companies when he created the Toll business in Newcastle, New South Wales, in 1888, by hauling coal using a horse and cart. Since its modest beginnings, Toll has become one of the Asia–Pacific region's leading providers of freight forwarding by road, as well as transporting by air, rail and sea, both domestically and internationally. It also offers a whole range of integrated logistics services, including warehousing, storage and distribution, end-to-end supply chain management and business logistics solutions. Today, Toll is the largest player in the Australian transport market with 8 per cent market share.

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 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'.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



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

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

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 IT experts.

E-commerce uses **electronic data interchange (EDI)**, email and 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

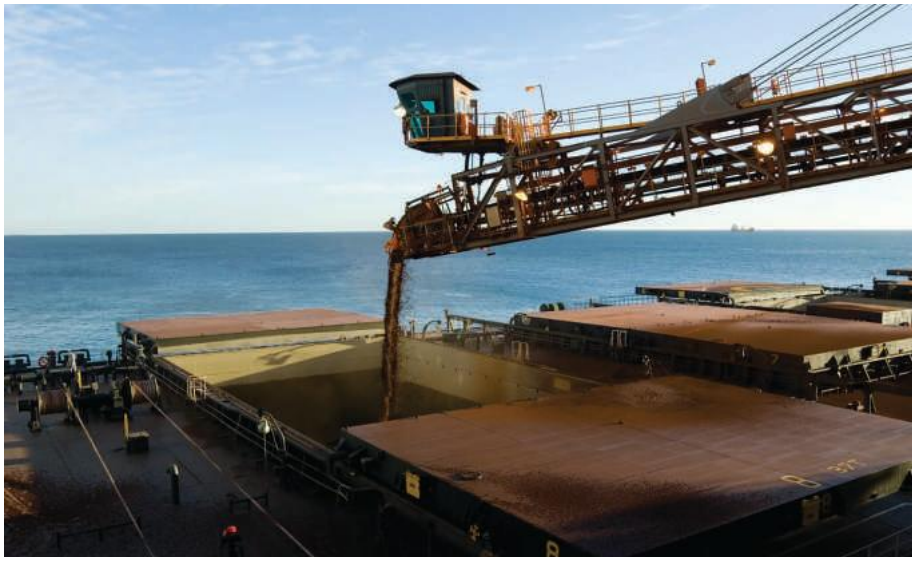
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 their 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 of 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.



Source 4.14 Globalisation has enabled businesses to access resources that were previously from distant locations. Here, a ship is loaded with iron ore for international export from Western Australia.

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

Business Bite

McDonald's Australia does not own any of its suppliers. The company has long-term relationships with eight key suppliers, including Australian Food Corporation (beef), Inghams Enterprises (chicken), and Simplot and McCain (potatoes). Some 92 to 94 per cent of its food and packaging needs are manufactured in Australia. McDonald's is looking to source more sustainable inputs as part of its corporate social responsibility (CSR) commitment. Suppliers must not contribute to deforestation, and must ensure they use quality environmental practices and act ethically with respect to their workforce. Globally, McDonald's is the single-largest beef buyer with 5 per cent of Australia's total beef production sold to the company. A consistent and reliable supply chain for its inputs has been a key part of McDonald's success.



Source 4.15 McDonald's is Australia's largest buyer of beef.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 4.16 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

Activity 4.3 Comprehension

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.

4.5 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

move to a different supplier, then any advantage from outsourcing may be lost.

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 4.17 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.

4.6 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.

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

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 4.18 A waiter records the customer's order on a tablet, and it goes automatically to the kitchen.

- 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.

Source 4.19 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 video conferencing; 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.

Established

This type of technology has been tried and proven 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 EFTPOS, has been used to offer better services and faster service delivery to anywhere in the world.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

4.7 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 per cent 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 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.

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.

Source 4.20 Technology such as barcode readers has made inventory management more efficient.



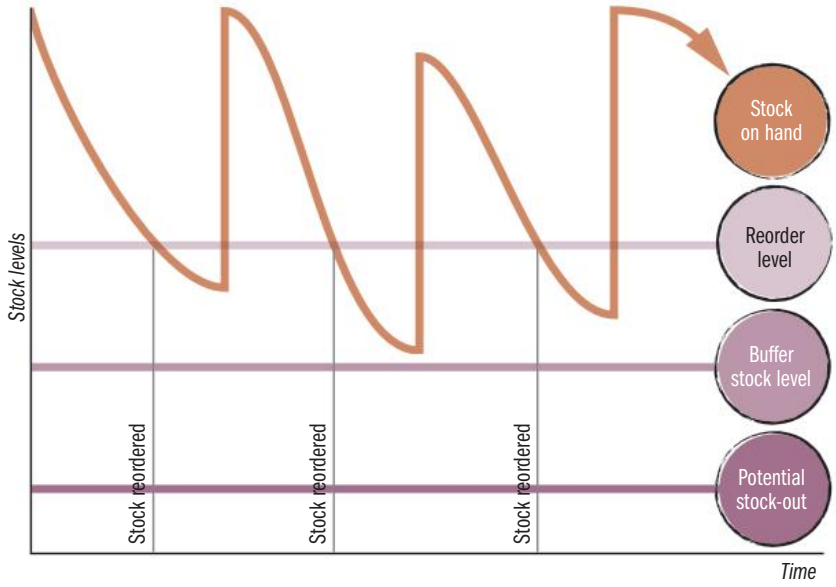
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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



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).

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 its competitor, JB Hi-Fi.

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.

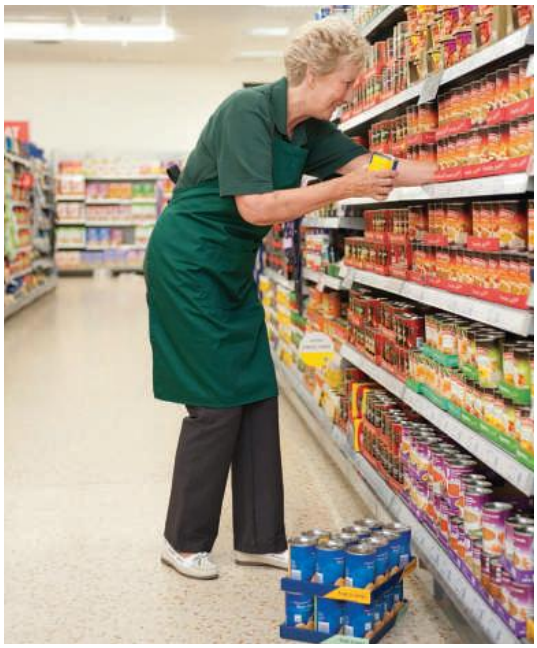
Overall, the challenge for inventory management is to have enough stock on hand to satisfy changes in customer demand and not be overstocked, so that

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 being more expensive than stock purchased at the start of the year.



Source 4.22 Supermarkets and other retail businesses rely heavily on the principles of FIFO.

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

Source 4.23 A business must have reliable and dependable suppliers who can respond to the business's inventory needs quickly.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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)
- 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 a further 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.

4.8 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 to ensure that 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.

Business Bite

The Australian Competition and Consumer Commission has implemented a new country of origin food labelling system country-wide, as of 1 July 2016, to be made mandatory in July 2018. It will require most foods that are grown, produced or made in Australia to have a label which states that the food is Australian grown, produced or made, and shows the minimum proportion of Australian ingredients. The label will also have a triangle with a picture of a kangaroo in it. The country of origin of any imported foods must be clearly and accurately stated on the label. Misleading consumers by word or image about the origin of the food is illegal.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

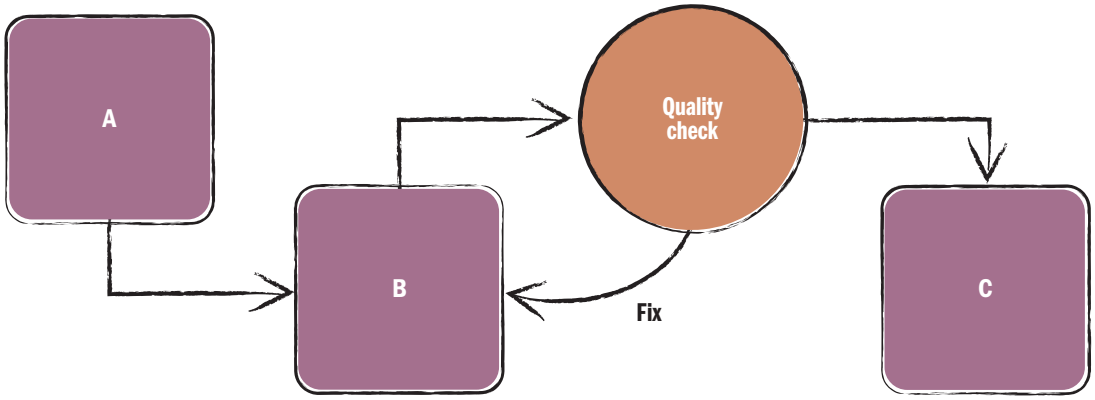


Source 4.24 Quality control is necessary to prevent increased expenses and customer loss.

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

Large motor mechanic businesses often send out a letter to 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.

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.



Source 4.25 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

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 the Institute of Chartered Accountants, the Law Society and the New South Wales Board of the Medical Board of Australia.

Business Bite

It seems that most car companies have had to contact customers to repair vehicle problems, sometimes proactively and at other times because they are required to do so by legislation. In 2010 Toyota recalled over 400 000 units of its 2010 model Prius and Lexus hybrids globally. The recall was prompted by customer complaints about slipping brakes while driving on bumpy roads. Even though there were only 111 cases reported globally, Toyota was very prompt in alerting customers. Through this approach Toyota has proven that it is a company committed to quality.

In 2012 Volkswagen (VW) commenced an international recall of 299 000 diesel-powered vehicles built since 2009, due to possible cracks in the fuel injection system that could lead to a fuel leak. This problem affected not only VW's own models, but also products from subsidiary brands Audi, Skoda and Seat. In 2013 VW recalled almost 26 000 cars in Australia after customer complaints about losses of power from the transmission and engine failures. This followed the death of a woman in 2011 after a truck hit her Golf, which had lost power. BMW, a name synonymous with quality, recalled 235 000 Mini vehicles worldwide, of which more than 3500 were in Australia.

However, the largest automotive quality scandal had its origins in 2015 when the United States Environmental Protection Authority discovered VW diesel engines had been programmed to 'cheat' their emissions test. Software that defeats emissions tests can affect fuel consumption and performance. An estimated 11 million cars produced by VW were affected. As a consequence, the VW Group CEO resigned and the company plans to spend US$7.3 billion to correct the issue.

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?

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 4.4 Discussion

1 Describe an appropriate strategy that could have been used to prevent a quality issue.

2 Explain why a firm would recall its product.

3 Evaluate what advantages and disadvantages a recall could present for the firm.

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 will prefer to deal with businesses with proven quality systems.

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 its results to management for consideration, who 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.

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.

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.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 4.26 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.

4.9 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 capital 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.

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

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

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

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.

Source 4.27 Employee redundancy entitlements

No. 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

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.

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 4.28 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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 4.29 The driving forces for change must outweigh the resisting forces.

4.10 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.



Source 4.30 Globalisation can present many cost-saving opportunities for businesses, such as outsourcing offshore certain operations like call centres.

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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

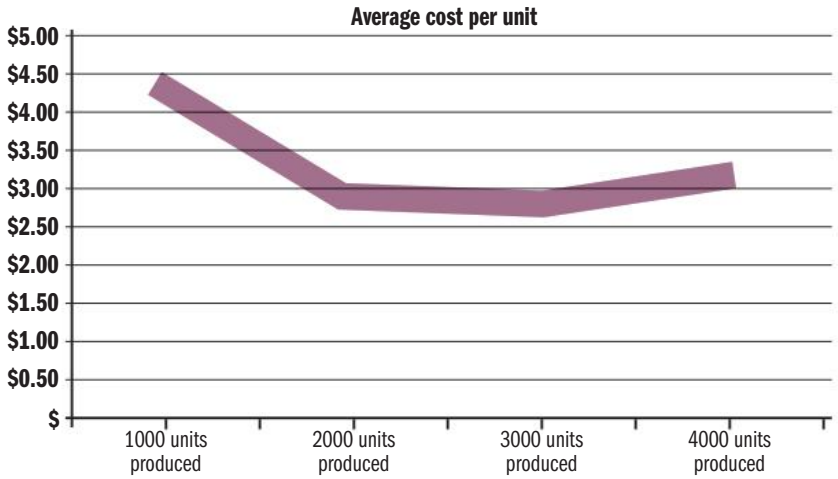
An option to achieve some of the advantages of economies of scale is to have a joint venture or strategic alliance with a business in the same industry. An Australian manufacturer may join with a foreign-based supplier and manufacturer to give both businesses advantages of economies of scale.

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.

Activity 4.5 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 4.31 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 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 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 maintain its competitive advantage.

Research and development

Research and development is commonly called R&D and 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 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 4.3 'New product or service design and development'.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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, Andrei 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. Huawei, which recently entered the Australia mobile phone market, is working to develop the next generation of ICT. Lenovo, which specialises in computer and smartphone manufacturing, has a prototype flexible smartphone that can bend into a bracelet. Samsung is also investigating how it can use graphene to gain an edge over Apple.



Source 4.32 Lenovo's flexible smartphone

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.
- 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.

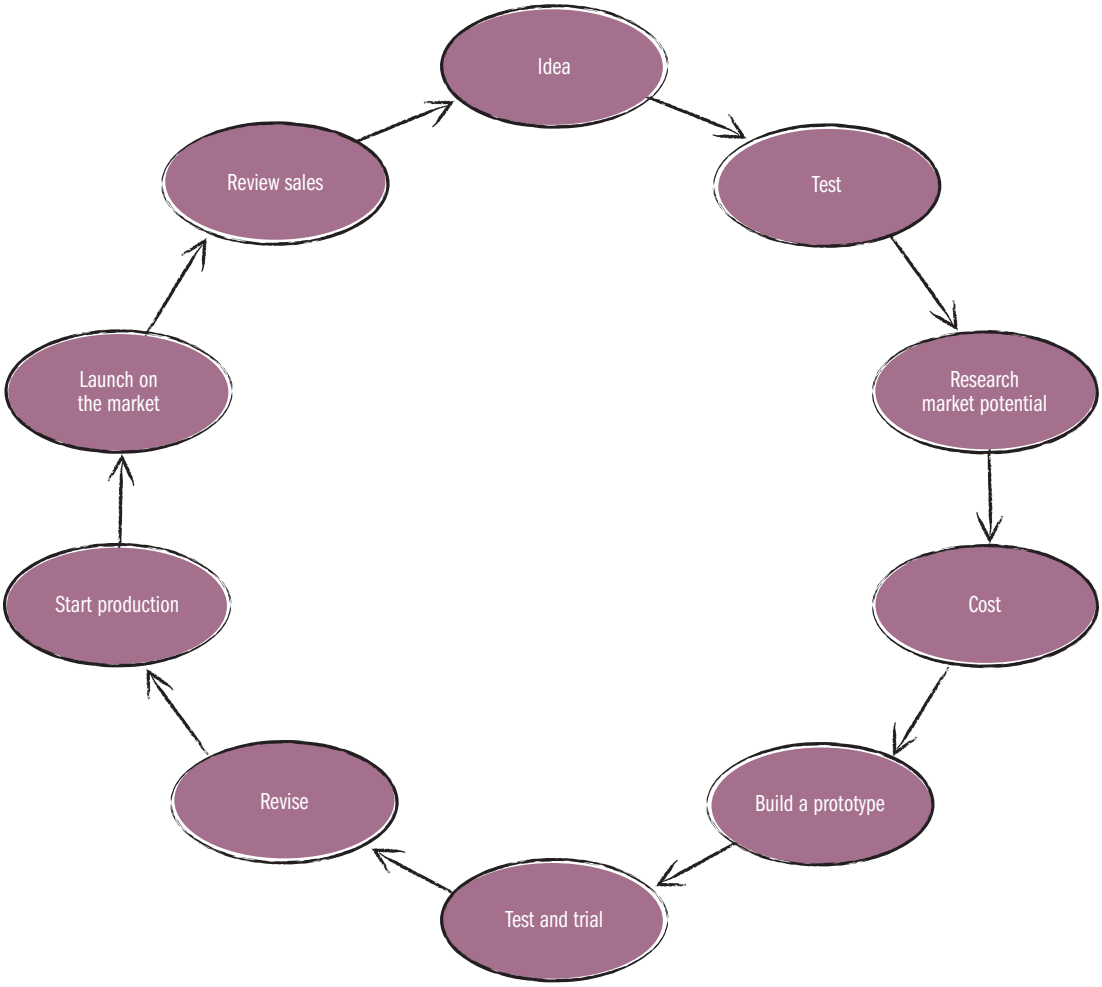
Innovation is not limited to products. Process innovation involves the development of the operations function itself to bring benefits to the business. New technology or JIT inventory management may be introduced or an innovation in the production method itself may be developed.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

There are limits on R&D, mainly because it is such a long-term, higher-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.



Source 4.33 Summary of the R&D process

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Which of the following is a disadvantage of upgrading technology?

A Better quality and employees with new skills
B Disruption to the operations process
C Lower operations costs in the short term
D More effective communication

4 What is an operational advantage of a business vertically integrating?

A The business has better quality control over its inputs.
B The business can earn revenue from the business it has purchased.
C The business can distribute its products to more countries.
D The business will have a global supply chain.

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 What is a stock-out?

A When a business runs the risk of running out of stock to make or supply products
B When stock levels reach the minimum buffer level
C The difference between when stock is ordered and when it arrives
D When a business is oversupplied with stock

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 What is e-commerce?

A When a business uses email to communicate to customers and suppliers
B When a business has an online store
C When a business uses the internet to both buy and sell goods and services
D When a business uses technology to get access to overseas markets

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

Short-answer questions

1 Describe the nature of the performance objectives of operations strategy.

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

3 Explain the difference between quality control, quality assurance and quality improvement.

4 Analyse the impacts of the global environment on operations strategies.

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

Extended-response question

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

5 Operations at Domino's

Chapter objectives

In this chapter, students will:

- explore the role of operations management at Domino's
- investigate the influences on operations management at Domino's
- explain the operations process at Domino's
- evaluate operations strategies at Domino's.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

5.1 Introduction

The Domino's brand entered the domestic fast-food market in 1983. The first store was located in Springwood, Queensland. There was an opportunity in the pizza home delivery market in Australia because the market for convenience foods and 'take-away meals' was growing rapidly. The Australian and New Zealand Domino's franchise was bought by Silvio's Dial a Pizza in 1993, and in 1995 the Domino's brand was launched. Additional Domino's stores were opened each year, reaching 500 stores Australia-wide in 2013. Each year more stores are being opened as the company expands. The combined operations of these stores produces approximately 140 million pizzas each year.

5.2 Role of operations management

Ultimately, the role of operations management is to support the achievement of the strategic goals of profitability and growth. Since its first store opened in 1983, Domino's operations have evolved to improve its pick-up and delivery services and focus less on in-store dining. The home delivery business is therefore the core of the business's operations. The highly competitive nature of the market means that Domino's primarily pursues a cost leadership strategy. In terms of a differentiation strategy, Domino's offers more varieties of pizza than any of its competitors. This is achieved using the Pizza Mogul website and mobile app, whereby customers can create their own customised pizza. Over 100 000 varieties are possible. These operations strategies have helped Domino's achieve its business goal of becoming the market leader in pizza in Australia.

As well as creating final goods in the form of pizza and meals, Domino's may be classified as a service-based business because door-to-door delivery is a key output of the operations process.

There is a strong interdependence between marketing and operations. Market research identifies the nature of consumers' needs and wants. Operations at Domino's must, therefore, supply pizza and other food at a quality that consumers expect. Operations must also reliably provide on-time delivery to the market. Thus the role of operations is significant for achieving marketing objectives while at the same time managing costs to reach financial objectives. Profitability and long-term growth of Domino's are key goals.

Differentiation through operations has been achieved by:

- a variety of pizza, side dishes and chicken snacks
- a variety of meal combinations
- incorporation of new technology
- quality and speed of service
- customised pizza designs.

Cost leadership through operations is achieved by:

- targeted business efficiency programs
- digital technology
- standardisation such as pizza base size
- economies of scale
- minimising waste.

Domino's philosophy is called 'Slow Where it Matters, Fast Where it Counts'. This is a key aspect of the Domino's vision to retain its competitive advantage and keep its reputation as the home delivery choice for all market segments.



Source 5.1 Domino's philosophy

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

5.3 Influences

Globalisation

For Domino's, globalisation has created opportunities to access other markets to sell the outputs of its operations. Owing to the similarity between customers that exists in different countries, pizza has universal popularity and the Domino's system is applicable in overseas convenience food markets. The Domino's brand, owned by Domino's Pizza Inc., a listed US company, is well known. Domino's Pizza Enterprises Ltd is the Australian division. The company holds franchise rights for New Zealand, Belgium, France, the Netherlands, Japan and Germany. There are operations across seven countries, with more than 2000 stores. Domino's Pizza Enterprises Ltd is the leading international Domino's franchise.

Economic

There are several economic influences on the business. These include the rising cost of labour, electricity, and general economic conditions in Australia and globally. Changes in the business cycle will be a significant influence owing to the discretionary nature of fast-food consumption. Interestingly, a downswing in economic activity and consumer confidence can increase demand for take-away pizza as consumers reduce their spending on restaurant meals and going out.

Technology

Technological developments in digital communication and industrial cooking equipment have had the most significant effect on Domino's. Both of these areas of technology have provided significant savings in terms of costs and time. Domino's has been an early adopter of technology, introducing online ordering via a website in 2005. An iPhone app was launched in 2009 to make the ordering process even easier. An Android app has also been developed. Digital ordering systems have made it possible for the business to improve the speed and efficiency of this aspect of its operations. This technology is significant for Domino's to achieve its goal of having the easiest online ordering system from any device so that customers can order in as few steps as possible, from anywhere and at any time.

Domino's also connects to its customers through a variety of social media platforms: Facebook, YouTube, Twitter and Snapchat. GPS tracking technology, introduced in 2015, allows customers to virtually follow their delivery driver using the maps functions of their smartphone. The 'pizza tracker' is also available on smartwatches. These technologies improve the wait-time experience by creating certainty about delivery, which further differentiates Domino's from its competitors.

Fast cook conveyor ovens can cook a pizza in 7.5 minutes. The new WOW2 fast bake oven, installed in 2015, reduces this time further as its air delivery system bakes both sides of the pizza up to 30 per cent faster than standard conveyor ovens. The ovens can be stacked, saving valuable space in the preparation area of the store. Another time-saving device is the pizza dough-sheeting machine, which can create a pizza base from roughly shaped dough in a few seconds.



Source 5.2 Domino's Robotic Unit (DRU)



Source 5.3 DRU drone by Flirtey

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

All information technology and management of inventory is controlled using PULSE software. This information management system improves efficiency, accuracy and productivity.

Finally, Domino's Robotic Unit (DRU) is part of the business's future innovations to reduce cooking times to three minutes in-store and delivery times to 10 minutes. The DRU is an autonomous vehicle that uses GPS tracking and sensory input to deliver products. At present, this 'robot' is still being tested. DRU drones are also part of Domino's delivery technology. In 2016 Domino's partnered with Flirtey to launch the first Civil Aviation Authority (CAA)–approved commercial drone delivery service. Drones could be used alongside Domino's current delivery methods.

Quality expectations

Operations must satisfy the expectations customers have for quality, speed of delivery and dependability. Poor operations will not achieve these objectives and Domino's would lose domestic customers to its competitors. Customer expectations are increasing all the time as advertising and promotion promises shorter delivery times, more pizza varieties and meal combinations, and better-quality products.



Source 5.4 Domino's is committed to providing customers with a great-tasting product.

Domino's has responded to customer expectations of faster and hassle-free ordering through its apps, which are faster than texting or browsing through an online menu. Customers can pay an additional fee if they wish to have delivery under 20 minutes guaranteed. Individual pizzas can also be customised to suit individual preferences and tastes. For example, customers can build their own meal and order half-and-half pizzas. Domino's is 100 per cent committed to providing great-tasting products and, therefore, operations are focused on consistency. Dough and sauce are the same in every store and each pizza has the right toppings placed correctly.

Cost-based competition

In the domestic market, Domino's faces considerable competition from Pizza Hut, Eagle Boys (until 2016), Pizza Capers and independent single operators. These competitors are all able to offer similar products at a similar price point. Each competitor also has a range of 'meal deals' that are very similarly priced. Direct price comparison between these businesses reveals that a family-sized supreme pizza costs between $12 and $15. At the budget end of the market, Domino's offers a $5 pick-up price for its traditional value pizza range. Pizza Hut also offers a $5 price for its medium-sized traditional range.

There is also considerable cost-based competition from frozen pizza brands such as McCain, Papa Giuseppi's and Dr. Oetker, which are widely sold in supermarkets. Woolworths Select brand and Homebrand pizza brands have prices as low as 60c per 100 grams. Domino's cannot offer prices this low as individual stores do not have the economies of scale of a large frozen food manufacturer. For Domino's premium product, there are also lower-cost gourmet products available such as pizzas sold under the Restorante brand. Gourmet frozen pizzas are a convenient and higher-quality product that are priced lower than Domino's can offer, at approximately $7.50 to $8.25 each.

Cost-based competition also exists from other fast-food chains with a drive-through service. McDonald's, Hungry Jack's and KFC are able to match Domino's on price and convenience. Red Rooster offers home delivery as well.

Therefore, the high level of cost-based competition in the market means that Domino's must ensure its operations are as efficient as possible so that low prices can be maintained, and that differentiation is achieved through variety of toppings and delivery speed.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Social and environmental sustainability

Domino's has recognised the importance of sustainability in all aspects of its operations. The company promotes recycling and aims to minimise waste, carbon emissions and energy use.

Given its reliance on delivery vehicles in its supply chain and cars used by delivery drivers, the business is committed to using more fuel-efficient and low-emission trucks and delivery scooters. Many stores have electric bikes as part of their delivery fleet in an effort to provide sustainable, environmentally friendly delivery options. Electric cars may play a role in the future as they become more commonplace in Australia. In the United Kingdom, Domino's is working with Renault to use electric cars to help the company's goal of reducing carbon emissions.

To reduce food waste from spoilage and having to dump unused ingredients past their use-by dates, Domino's uses PULSE software to manage inventory to avoid ordering excess food ingredients. Recycling of cartons and pizza boxes is encouraged in-store. However, the most difficult item to recycle is used pizza boxes as oil and fat residue can ruin an entire batch of paper and cardboard recycling.

In response to social pressure for a healthier product, sodium and fat have been reduced in Domino's foods. Calorie content and all relevant nutritional information is published on its website. In 2015 Domino's announced the removal of all artificial colours, flavours and preservatives from its pizza menu.

Many local councils accept Domino's pizza boxes in their recycling bins, so they are very easy to recycle.

5.4 Operations processes

The operations process at Domino's involves transforming inputs to meet the needs of customers; that is, food ingredients are combined and cooked to create finished meals ready for immediate consumption.

Inputs

There are five main categories of inputs: materials, information, customers, human resources and facilities.

Materials

Domino's uses a wide range of ingredients as raw material inputs that are transformed. Each pizza base has identical inputs. The dough is made from scratch daily in-store using a prepacked dough mix while the sauce is also premade and delivered to each store to ensure freshness. There is a choice of 40 different pizza toppings, although a standard supreme pizza has seven toppings plus oregano and spring onion.

Information

Domino's relies on current and accurate information to organise its operations in the most efficient manner. The most significant information input is the recipe for each individual pizza. Pizza-make charts are posted in the preparation area. This ensures consistency, as each pizza is topped correctly. Other information inputs are calorie content and preparation times for each menu item.

Information from online orders is analysed to determine demand for particular types of pizza as well as peak times for overall demand. Customer questionnaires are also used. From this information a Domino's store can order an appropriate quantity of ingredients and do the necessary pre-preparation to manage peak demand without compromising delivery times. PULSE data management is a critical part of the business's operations. Information from this software is used to accurately estimate the operations process completion time.

Information about how many orders a store is processing, order size, delivery distances and traffic density is used in an algorithm to calculate the likelihood of a driver completing a home delivery within a 15- or 20-minute time frame from when the confirmation email was sent to a customer for their order. From this information a Domino's store can guarantee a delivery time.

Customers

Customers are an input because they are changed from a hungry state to one that is satisfied. Domino's encourages feedback from its customers because the business aims to meet their specific requirements. Customer surveys, responses to its complaints and compliments form on its website, online cooking blogs and social media comments can provide Domino's with information to analyse for improving its operations and to determine if there is a demand for new products. For example, the Chef's Best range pizza was introduced as a consequence of customer feedback.

Human resources

With Australia and the six other overseas markets, Domino's has more than 60 000 employees while

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 5.5 Staff at Domino's

individual stores average around 30 staff. Each store has frontline staff, dough makers, pizza makers, cutters, delivery drivers as well as a store manager. Employees are well trained and multi-skilled and therefore able to perform any task within the operations. The most visible are the counter staff and pizza cutter. The pizza cutter ensures that customers waiting in-store witness a final quality check before the meal is handed over.

Facilities

Rather than a centralised factory such as a frozen pizza manufacturer would use, Domino's has highly decentralised operations. The most obvious of Domino's facilities are its individual shops, which are relatively small and must use space efficiently. Within each store is the essential pizza-making equipment and facilities to create and distribute finished products to customers. The facilities at each store include:

- dough-sheeting machine
- conveyor oven
- pizza-holding cabinets
- refrigeration equipment.

Equipment and facilities are arranged in a process layout to ensure a smooth flow of inputs through each work station. Finally, Domino's sophisticated PULSE data management system is a key asset for analysing all aspects of inventory and the operations process.

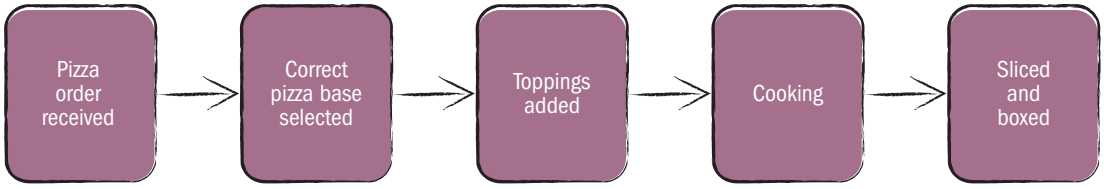
Transformation processes

Pizzas are made as individual 'jobs' flowing along a production line; therefore, the operations process is more like a large factory using assembly lines. However, each product is customised at the start of the operations process and thus made to order. Large meal orders are processed as a batch to ensure that each item is completed at the same time and to prevent a food item delaying delivery. Pizza bases are prepared in advance for each day's orders so that these are ready for the start of the operations process. At the pizza make station, ingredients are added in the most efficient order, usually finishing with a cheese topping. The raw pizza in placed in the conveyor oven to cook before emerging as a finished output. The pizza cutter will slice and box up the order ready for delivery. The faster this process occurs, the more orders a Domino's store can fulfil per hour. Therefore, Domino's is about to increase the overall productivity of its operations.

Volume, variety, variation in demand and visibility

Domino's is no different from other businesses in that its operations are strongly influenced by the four Vs. Being a large company, Domino's makes over 140 million pizzas a year across its seven markets, with this number steadily rising as the company grows and opens more stores. Each store will have a high volume of output contributing to this figure. However, as there are approximately 100 000 possible ingredient combinations, on five different types of bases, variety is the most significant influence of the 4Vs on operations. Variety is further enhanced through different combinations of items to make up a pizza meal deal.

Overall variation in demand is relatively steady across a year. A typical customer will order at least once in any four-week period. However, sales can be higher during the winter months. Orders tend to be higher



Source 5.6 Pizza transformation process

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

during school holiday periods as well. Special events such as sporting grand finals and New Year's Eve also witness a spike in sales. In a typical week, Domino's busiest period is Friday and Saturday evenings between 5 p.m. and 7 p.m. Domino's aims to 'smooth out' the variation in demand between Monday and Sunday by promoting its value range of pizzas mid-week.

Visibility is quite high for some aspects of pizza. This is because in-store customers have direct contact with frontline staff and can see their finished pizza emerge from the oven. It is possible in some stores to see preparation staff at work; however, it is unlikely that customers will ever see the full process of the creation of their pizza. Store layouts are being changed to bring the kitchen to the front of the store and therefore increase visibility.

Sequencing and scheduling

Preparation of a pizza must follow a clear order of steps. The sequence begins with the pizza base before ingredients are added in the correct order to ensure quality and consistency. Then the pizza is ready for baking. Task analysis is used to determine the precise sequence in which individual ingredients are added to minimise preparation time. Pizza bases are prepared in advance.

Critical path analysis can enable Domino's to achieve the fastest pizza preparation times. The critical path is limited by the cooking time of a pizza. However, during this time it is possible to prepare other parts of a meal deal for the customer order or begin a new customer pizza order. This process increases the potential number of orders per hour and reduces time between the customer order and delivery.

Outputs

As a service-based business, Domino's needs to satisfy the needs of its customers; that is, to deliver pizza to a destination on time, ready to eat. Service therefore also includes interaction with delivery drivers.

As a product-based business, Domino's has a wide variety of outputs on its menu. There are different types of pizza bases: Classic Crust, Cheesy Crust, Deep Pan, The Edge, Gluten Free and Thin'n'Crispy. There are five categories of pizzas: chicken and prawn types, chef's best, traditional and value. In addition, side dishes of bread, chips, chicken and dipping sauces as well as drinks and desserts can be added to create a meal deal. Owing to the option of custom-designing a pizza, it is possible to have over 100 000 varieties.

Overall, there is a 50:50 mix of goods and services.

		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 5.7 The four Vs



Source 5.8 Domino's Supreme pizza

Customer service

Domino's aims to differentiate itself from its competitors by providing a level of service that exceeds the expectations of its customers; that is, delivery in time that is faster than customers anticipate. The 'Fast Where It Counts' philosophy means ensuring drivers are ready to go for delivery from the store to the customer's door. Another aspect is Domino's willingness and ability to customise orders and modify meal combinations to suit the individual preferences of a customer.

Given the fact that the industry is already very cost-efficient and there is little difference in prices, a faster level of service and customisation is necessary to gain a competitive advantage. Domino's aims to increase its share of the home delivery market and achieve year-on-year growth through its customer service strategy.

Warranties

Domino's stands by its quality claims that customers are guaranteed to get a fresh, hot pizza, and if not satisfied the store will replace it. All food services and businesses providing meals are legally

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

obligated to ensure that products are safe for human consumption. Food safety is governed by the *Food Standards Australia New Zealand Act 1991*. Under this legislation Domino's must have correct controls in place throughout its supply chain to ensure food safety. These controls cover receipt, storage, processing, display, packaging, transportation, disposal and recall of food. For example, raw ingredients must be refrigerated. In addition, all employees must receive correct training to ensure that health and hygiene practices are followed. Other requirements under the law concern premises and equipment, and food transportation vehicles. These requirements are designed to eliminate any risk to consuming a Domino's product. In addition, all allergen and nutritional information is published on its website. Although Domino's offers vegetarian and gluten-free pizzas, it cannot guarantee that no cross-contamination will occur.

Another aspect of Domino's guarantee is that participating stores offer a 15- or 20-minute delivery time for an extra charge. If Domino's cannot fulfil an order or fails to deliver on time, customers are provided with a voucher for a free pizza.

5.5 Operations strategies

Performance objectives

Of all the performance objectives – quality, speed, dependability, flexibility, customisation and cost – speed and cost are the most important to Domino's. Cost was the original point of differentiation for the business when it launched its pick-up and home-delivery service. However, with increasing competition in this market segment, speed of service now gives Domino's a sustainable competitive advantage.

Quality for Domino's means meeting expectations of customers. The quality objective is assessed through factors such as friendly and helpful interactions with staff, tasty food, clean stores, courteous delivery drivers, a website that is easy to navigate and online ordering that operates without malfunctions. Quality is also measured by consistency of outputs. Each pizza must have the correct size and shape base, even spread of sauce and the correct quantity and arrangement of toppings.

Speed of operations is assessed by measuring how quickly customers can order. The speed at which customers can make an order has been increased dramatically through mobile apps. The speed of the transformation process is improved through faster cooking times. With the introduction of new fast bake conveyor ovens cooking times have been reduced from 7.15 minutes to approximately 4 minutes. Finally, speed is measured in terms of the time of delivery to a customer address. The best delivery time performer is the Palm Beach store on the Gold Coast, with an average of 9 minutes and 49 seconds. Australia-wide, delivery times have fallen from 27 minutes to a 22-minute delivery average.

Dependability is the reliability of the product or service. For a pizza shop, dependability is measured by the percentage of on-time deliveries. A number of variables can limit a store's ability to achieve this objective, such as how busy the store is, how complex the order is, poor weather, high traffic density and distance to the delivery address. Domino's aims for all deliveries to occur in as short a time as possible. Domino's dependability objective is achieved using its GPS Driver Tracker. Customers can follow their order using their smartphone or other device, reducing the uncertainty about when their meal will actually arrive. Research by Domino's revealed that customers dislike waiting and, therefore, missing out on the things they enjoy. In addition, customers can monitor when their pizza is being made on the make line, when it has been put into the oven for cooking, and when it is ready in-store for pick up or leaving the store for delivery.

Domino's is able to produce unique products because its operations process allows for a high degree of customisation. As customers can design their own pizza from a choice of different bases and toppings, over 100 000 varieties of pizza are available. In addition, customers choose from a range of items for a meal deal, adding and subtracting items to suit their desires.

Cost is a key operational objective for a pizza store. This objective may be incompatible with other objectives. Quality, dependability and flexibility can suffer in an effort to drive costs lower. A significant cost for each store is labour owing to the labour-intensive nature of the make line. Each pizza must be costed according to the costs of the ingredients, labour, materials as well as lighting and energy. Data is used to predict the minimum number of employees required for each shift to minimise labour costs.

Pizza shops generally have flexible operations and therefore can increase or decrease the number of pizzas per hour. However, there is a maximum output

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

limited by cooking times. Owing to the high cost of cooking equipment and labour it is uneconomical for Domino's to have excess capacity; that is, spare ovens and staff waiting in case there is a sudden increase in demand.

Canstar Blue is a customer satisfaction research and ratings business that publishes its findings to help consumers make better purchase decisions. In its ranking of pizza store brands, Domino's consistently achieves 4 out of 5 stars based on customer satisfaction ratings for delivery, menu variety, service and overall satisfaction.



Source 5.9 Quality is important to Domino's and even the spread of pizza sauce is expected to be of a consistent standard.

New product design and development

For Domino's, new products are principally new varieties of pizza, dough types and meal combinations. There are ongoing developments in adding a wider range of exotic pizza toppings, drinks and desserts. For example, stuffed-crust bases and rectangular bases have been developed. Changes in eating habits and healthy lifestyle choices have led to the inclusion of gluten-free pizza bases and vegetarian pizzas in Domino's menu. In addition, there are various options that can be customised to become vegan.

In terms of the service component of its products, Domino's has used digital innovation to improve the efficiency and effectiveness of its online ordering. SMS ordering, using emojis, Zero Click ordering and GPS Driver Tracking have been significant developments. Domino's is working towards cooking times of three minutes and delivery within 10 minutes under Project 3-10. As noted earlier, autonomous delivery using the DRU robot and drones is under development. Any autonomous delivery vehicles or AI development has been introduced as an addition to traditional delivery and customer service roles: Domino's is not planning to use them as a replacement of any staff.

Supply chain management

Effective supply chain management and logistics can be a business's strengths. Domino's must ensure that each store has sufficient dough, sauce and ingredients ready for each shift. Dough mix is sent to each store so that dough can be made in-store daily as needed and the sauce is pre-made and delivered to each store. Food ingredients are sourced from both local and international suppliers. Deli meats for toppings are sourced from Tibaldi in Melbourne and Primo Smallgoods in Sydney. Other ingredients are sourced from Comgroup Supplies, a food manufacturer in Brisbane. Mozzarella cheese, cheese blends and pizza cheese are sourced from Leprino Foods, based in the United States. All packaging materials are supplied by Australian box manufacturer Visy.

Outsourcing

To ensure that it has control of every aspect of its operations and to maintain corporate secrets, Domino's does not outsource any of its operations.

Technology

Domino's has differentiated itself through using technology at all stages of the ordering, delivery, pick-up and purchasing process. The most significant technology for Domino's has been the implementation of e-commerce for customer orders. The company prides itself on being the market leader in adopting digital innovations.

Cost and speed advantages can also be gained through developments in new faster and more energy-efficient cooking equipment, such as the WOW2 fast bake oven. While the company may eventually use autonomous vehicles to deliver its products, DRU and drone technologies can be considered leading-edge and were only being trialled in 2016.

Inventory management

Inventory management is a critical success factor for operations. If the necessary ingredients are not available, customer orders cannot be fulfilled. This would be highly detrimental to the Domino's brand as dissatisfied customers can easily switch to a

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

competitor. Data for inventory on hand and in use is recorded so that each store has enough stock to meet the expected orders for an evening. Each store must ensure that it has enough pizza boxes ready and available – both normal size and Chef's Best. Carrying too much inventory can lead to spoilage and waste. Some inventory items are delivered daily, such as dough and sauce pre-mix, and therefore the inventory management may be classified as just-in-time. Buffer stock of frozen ingredients is kept on hand. At the conclusion of each shift, leftover stock is checked, weighed and stored.

Quality management

Domino's has a performance objective of the highest-quality products, and therefore quality control, assurance and improvement are essential. There are many different factors that contribute to quality. Driving quality improvement at Domino's is its 'Slow Where It Matters, Fast Where It Counts' philosophy. The first aspect of this philosophy is to ensure the store is ready for busy periods. The make line is organised, pizza-make charts are visible and bases are prepared. The second part of the philosophy ensures quality in terms of staff being ready to make prompt deliveries.

Domino's uses a number of quality strategies to achieve its high-quality operations objective. Prior to the opening for business each day, staff will thoroughly inspect all ingredients and inputs. Quality assurance is achieved through following specific checklists for cleaning the whole store, the preparation area and preparing ingredients. If this is followed correctly, each store will be ready for any order in minimal time and each customer's order will be prepared without mistakes, problems or omissions.

To ensure quality in terms of texture, the dough is tested by selecting a random sample for a stretch test, in which a small piece of dough is stretched to create a 'window frame'. When the dough is at the right consistency, it is possible to stretch it until it is very thin (it can almost be seen through) before it tears. When transformed into bases, a stretch machine and visual inspection are used to ensure that each base is a precise circle and the correct diameter.

Each pizza will be topped correctly and each variety of pizza is made consistently. That is, ingredients are evenly distributed on the base and each pizza has the same amount of toppings. Topping applicators are used so that neither too much nor too little is added. A customer can expect a pizza ordered on a busy Friday night to be exactly the same as one purchased during the week. This reduces costs and waste by reducing the number of remakes and ingredients lost from not being prepared.

Customers will value on-time delivery as well as positive interactions with staff. Feedback from customers and its website are used to assess this aspect of quality. Data for delivery times is kept and analysed each evening and each week to calculate average delivery times, and these are compared over time. Finally, Domino's reviews and responds to customer enquiries in order to improve the products, delivery and overall quality of service.

Change at Domino's

The most significant change has been from the 30-minute average delivery time down to nearly 20 minutes. Some stores can average a weekly delivery time of 10 minutes. Change at Domino's has been concerned with the decision to introduce new e-commerce ordering systems and trial autonomous delivery vehicles. Online orders represent more than 60 per cent of customer interactions and the goal is to reach 80 per cent. Dialling a pizza is much less common. Eventually, all customer orders will be 100 per cent digital. These changes will have significant impacts on the human resources function as staff will need additional training and more delivery drivers may be needed.

Domino's itself is phasing out its processed ingredients. The strategic goal is to have no frozen ingredients and to use all fresh produce. This will actually save inventory management costs because it will remove steps in the supply chain as ingredients will not need to be packed, frozen, and defrosted and stored again.

Finally, Domino's has created DLAB, an innovation centre in Queensland. The purpose of this centre is to bring together creative entrepreneurs and Domino's staff to generate ideas, explore emerging technologies and develop new innovations. As well as supporting new business start-ups, ideas from DLAB could be applicable to Domino's operations and inspire new products. Ideas from DLAB could be the drivers of strategic change at the company.

Global factors

The main global factors affecting Domino's are global sourcing, economies of scale, scanning and learning, and research and development.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 5.10 The DLAB innovation centre

Global sourcing

Transformed inputs for a pizza include dough, sauce and toppings. Nearly all toppings are sourced from Australian food manufacturers. Domino's strongly supports its business partners in Australia and, therefore, has better control over its supply chain. Only specialist pizza cheese is imported, from Leprino Foods in America.

Economies of scale

For Domino's, significant cost savings and quality control in operations can be achieved by pre-making pizza sauce and dry dough ingredients at a central location. These are delivered to each store on a daily basis. Other bulk-buying advantages can be achieved by purchasing toppings in large quantities from local food manufacturers. At a store level it is difficult to achieve economies of scale. Operations are as efficient as possible. However, frozen pizza manufacturers will always have an advantage over Domino's in terms of economies of scale.

Scanning and learning

Domino's is constantly scanning and learning new ways to improve its business. It was the first pizza franchise to see the potential for digital technology. Domino's scans and monitors the activities of its competitors such as Pizza Hut, Crust and Pizza Capers as well as fast-food competitors McDonald's, Hungry Jack's and KFC. This is to ensure it is aware of any attempts by its competitors to gain a competitive advantage in operations. Domino's senior management and CEO travel extensively to learn about industry-related research and innovation. The CEO also regularly travels to Domino's stores in its overseas markets as well as making trips to Silicon Valley to learn about digital innovations. Domino's DLAB will also help the company learn about new ideas and developments from outside the industry that could be applied to the business. The company aims to learn all about innovations and developments that could benefit the company using these strategies. In 2016 Domino's began presenting a tech innovation event called Abacus Tech Series. This twice-yearly event is a platform to showcase the company's digital developments and first-to-market technology.

Research and development

Domino's uses market research to analyse changes to operations that could improve the speed of its service and its product range; for example, Chef's Best was to provide a pizza of restaurant quality. The company has had great success with the order and home-delivery part of the business and is researching ways to improve service to pick-up orders. Domino's has the capability to track customers' locations via their mobile phones when they opt-in to On Time Cooking. With the new On Time Cooking feature on the Domino's app, customers will be tracked until they get to the store, ensuring their pizza goes into the oven at the ideal time. They will arrive just in time for their pizza. However, further research into the impact on consumer privacy is being undertaken.

Research and development into industry technology is undertaken by food processing and equipment manufacturers such as Middleby Marshall.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Multiple-choice questions

1 How does Domino's achieve cost leadership?

A Customised pizzas
B New pizza varieties
C Opening more stores
D Standardisation of inputs

2 What environmental sustainability strategy has Domino's implemented in its operations?

A Electric cars
B Fast cook ovens
C Inventory management software
D Solar power

3 What statement best describes the transformation process at Domino's?

A Assembly lines are used
B Cooked pizzas are delivered to customers
C Ingredients are added to a pizza base which is cooked in an oven
D Pizza bases are cooked, cheese and other ingredients are then added

4 Which of the following is a transforming resource used at Domino's?

A Customers
B Electricity
C Employees
D Materials

5 What is supply chain management at Domino's?

A The management of deliveries
B The management of all suppliers of inputs and delivery of outputs
C Sourcing pizza ingredients and other inputs
D Ensuring enough pizza ingredients are available at all stores

Short-answer questions

1 Outline one quality management strategy used at Domino's.

2 How does Domino's satisfy customers' quality expectations?

3 Explain how technology is both an internal and an external influence on operations at Domino's.

Extended-response question

Analyse the impact of performance objectives on the operations function at Domino's.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Topic 2

Marketing

25% of indicative time

Principal focus

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

Introduction

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 promotional and pricing 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 the interests of stakeholders such as consumers, business and the environment within the marketing process.

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 where 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, then, 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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, and the impact of government regulation
- assess whether the marketing of goods and services is most effective when a variety of promotional strategies is used
- evaluate a business's marketing strategies for a good or service
- analyse a business's marketing plan
- explain the impact globalisation has had on the management of marketing.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

6 Role of marketing

Chapter objectives

In this chapter, students will:

- investigate the strategic role of marketing
- analyse marketing's interdependence with other business functions
- evaluate different types of markets.

Key terms

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

6.1 Introduction

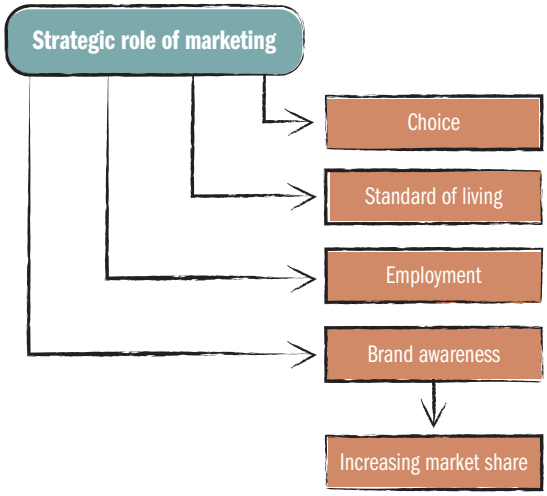
Marketing is the process of developing a product and implementing a series of strategies aimed at correctly promoting, pricing and distributing the product to a core group of customers. More than any other business function, it is the role of marketing to develop and implement strategies that generate 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. The purpose of this is to determine what the business should be producing.

It 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.

6.2 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 opportunuty to maximise its scale and profits. It also extends beyond the business itself, and its influence is shown clearly through its impact on society.



Source 6.2 The strategic role of marketing

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 6.1 It is the role of marketing to research customers' needs and wants in a market, and to help a business tailor its products to suit those consumption patterns.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 relate to 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, Apple Inc. is a consumer electronics company that is highly regarded as a market leader in consumer technologies such as smartphones and tablets. Apple is seen by consumers as an innovator. Its products are highly regarded for the ease with which they can be used, the many features they offer on the one device and their quality. The reputation of these products is outstanding and, as a result, those customers who place emphasis on innovative consumer technologies when deciding what to purchase will consider the Apple range of products. Other businesses gain a competitive advantage in the area of price. Brands such as Huawei and Motorola are priced at the lower end of the market and would have greater appeal to more price-conscious customers.

Standard of living

To ensure that businesses are providing consumers with goods that appeal to the 'want' element of human behaviour, organisations will 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



Source 6.3 Businesses must provide consumers with products that increase their standard of living.

Business Bite

In your local supermarket, stand in the tea and coffee aisle and look at the tea range – black, green, white, loose-leaf, bag, organic and so on. There might seem to be too much choice. Nerada Tea is an Australian-owned and operated tea manufacturer based in North Queensland – the largest supplier of tea grown in Australia. It also offers green teas, flavoured teas, imported herbal infusions and a range of instant tea mixes.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

telephones would be pocket-sized, mobile and with internet access, or that computers would be hand-held and 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 have 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. Bakeries have now developed a range of bread types catering to the diverse dietary and nutritional requirements of a varied and changing society. Basic necessities such as milk and bread are now available to suit the broad range of health concerns that consumers may have.

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.

Ethical spotlight 6.1

If businesses are attempting to improve the standard of living of consumers, why are people forced to pay high prices for goods that are often considered to be needs?

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 from consumers.

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

Brand awareness The extent to which consumers are aware of 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.

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

Source 6.4 Nike's Swoosh is globally recognisable.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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. Coles Supermarkets has effectively used the very simple slogan 'Down, down, prices are down' to heavily promote its image of a low-cost grocery store. It has sought to do this to convey an impression that prices are falling at Coles and to lure customers away from Woolworths. It has also used the slogan 'There's no freshness like Coles freshness'. The purpose of this was to promote the grocery store in direct competition with 'Australia's Fresh Food People' – Woolworths.

Business Bite

In the global toy market, Danish company The Lego Group has in recent years greatly increased its market share. With Lego's extensive range of construction sets and toys, popular licences such as *Star Wars*, video games, movies and increasing popularity in new markets like China, this is not hard to believe. However, in the toy game Lego can't yet claim the title of world's largest company. Mattel, maker of Barbie and Hot Wheels, has reported slightly greater annual profits than its major rivals Lego and Hasbro, the owner of Transformers and My Little Pony.

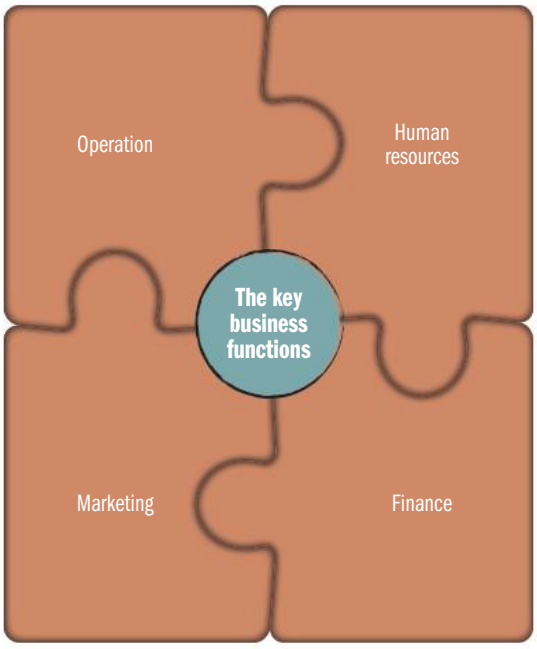
Activity 6.1 Comprehension

1 Marketing provides consumers with choice. With the use of examples, identify and outline two methods used by business to do this.

2 Describe the importance of market share to a business operating in a highly competitive environment.

6.3 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 6.5 The key business functions

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 café will require bread, an assortment of meats and vegetables, and beverages to present the customer with a finished product.

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.

How is the human resource management 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 features of the product would come 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 it to others.

How is the accounting and finance function related to marketing?

The **marketing function** involves finding out what consumers need and want, and linking these research 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 a business influence its ability to grow and develop.

The **accounting and 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

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

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.

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

Source 6.6 In many instances, staff are the public face of the business.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

assess the business's ability to acquire additional finance when and if it is needed. All these functions are interdependent. There is heavy reliance on the functions working together as a team, resulting in the business as a whole operating efficiently and profitably.

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 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.



Source 6.7 Competitive pricing has long been a key part of marketing campaigns for businesses.

Activity 6.2 Diagram

1 Create a mind map that outlines the role of each key business function.

2 In each section, identify how the key business function is interdependent with marketing.

6.4 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 to satisfy 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.

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.

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.

Selling approach

While product quality was seen as an important feature of the marketing process, 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 6.2

Examine the extent of honesty in the selling approach. Should the desire to achieve sales override the need for the business to be honest with its customers?

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Marketing approach

Businesses have now recognised the importance of developing an integrated approach to selling. 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.



Source 6.8 Successful marketing makes the consumer desire the product and think it caters to their needs.

Activity 6.3 Comprehension

1 Explain why businesses may benefit from using the production approach.

2 Outline the importance of promotion to the selling approach.

6.5 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 are BHP Billiton and Rio Tinto. They produce iron ore, copper, coal and gold. 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. In recent years, Australian discount grocery store Aldi has entered the wine market seeking to sell quality Australian-produced wines at low-cost prices. Such has been Aldi's success, its $4.99 bottle of red wine was awarded the same prize as a prestigious $65 competitor. Yet, Aldi itself does not have the production facilities to produce wines, so who is behind this venture? McPherson Winery is an Australian-based winery that is highly regarded for its quality wines. Aldi uses the intermediate market to purchase wine products from McPherson. Aldi then

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 6.9 McPherson's winemaker, Jo Nash.

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.

labels the wine under a different name, exclusive to the grocery store, and sells this as an Aldi product.

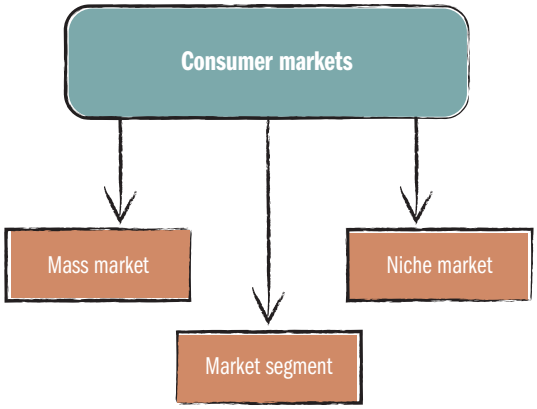
Intermediate markets

Intermediate markets are commonly referred to as wholesalers. They sell products to retail businesses that have been produced by other organisations. Wholesalers generally do not sell products to consumers. Aldi is a German-owned Australian grocery store chain that seeks to develop a supply-based relationship with manufacturers of common household products.

Consumer markets

Consumer markets are the most recognised markets in the business environment. They are where 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, Panasonic manufactures many consumer electrical goods (including digital cameras, televisions, video cameras and DVD recorders), but does not sell its products directly to consumers. Instead, the products are sold to stores such as Harvey Norman, Myer and David Jones and these stores act as the market where consumers can access Panasonic-branded products.

Consumer markets can be broken down into three categories (see Source 6.10).



Source 6.10 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. Radio stations often target one market segment of the overall radio-listening market. The owners and management team of Sydney radio station WSFM 101.7 Pure Gold, for example, have decided to aim their product at adults aged 35 and above. To appeal to this market segment, they play a broad selection of female-friendly music, place an

Business Bite

IGA is an independent supermarket chain that stocks a range of locally made products. As an independent grocer, IGA aims to be an active participant in local life, supporting sporting teams, surf clubs, hospitals and local schools. It is heavily involved in community programs and other charitable and worthwhile causes.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

emphasis on comedy and encourage their listeners to call in and share with the audience aspects of their life experiences.

Niche markets

A niche market is a smaller section of a larger market segment. While a business targeting a niche market would still focus on a select group of customers, a niche market differs from a market segment in that its customer base is narrower. 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 such examples.



Source 6.11 Bridal gown designers 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.

Activity 6.4 Classification

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

1. A mining company has discovered iron ore deposits in Queensland.
2. A motor vehicle production company uses tyres produced by Kuma Runer Automotive.
3. A bread manufacturer has released a type of bread that appeals to a variety of consumers.
4. An electronics store sells a range of television brands, including Panasonic, Samsung and LG.
5. A jeweller specialises in bridal jewellery.
6. A TV station believes its niche market to be males aged 40 years and over and interested in sport.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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: refers to the extent that 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 resource management 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

The four markets in the marketing process are resource markets, industrial markets, intermediate markets and consumer markets.

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.**

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Multiple-choice questions

1 How may marketing best be 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 Mobile Buzz has developed a new marketing plan that seeks to attract the interest of young adult mobile phone users. With which strategic role of marketing is this concerned?

A Choice

B Market share

C Standard of living

D Brand awareness

3 Which of the following strategies could a business use to increase its market share?

A Market research

B Discount pricing

C Product testing

D Quality control procedures

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 Hannah Hi Fashions has developed a new range of female swimwear aimed at women aged between 18 and 35 years of age. What is this new product's market commonly referred to as?

A Resource market

B Mass 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 'Think different' and 'i'm lovin' it' are the slogans that Apple and McDonald's use to promote the quality of their products. Which form of orientation do these slogans emphasise?

A Selling

B Marketing

C Societal

D Production

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 that consumers will respond positively to.

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 which the marketing function becomes responsible for promoting.

9 Top of Hill Mines is one of Australia's largest iron ore exporters. Which type of market does this business operate within?

A Resource
B Industrial
C Intermediate
D Consumer

10 Quicksmart Supermarkets has developed a marketing strategy that incorporates an emphasis on production quality, discount pricing and a wide distribution of its stores. Which of the following approaches is the business using?

A Production
B Selling
C Marketing
D Relationship

Short-answer questions

1 **a** Explain how a consumer market differs from the other types of markets in the business environment.

b Describe and give examples of the three types of consumer markets.

2 Adriana has decided to establish a homewares store. She believes that the quality of her products, for which she has been recognised, will ensure the success of the business. Vanessa is opening a similar store, but has conducted market research to develop a more thorough understanding of her local area and its needs. Outline how the approach that Adriana is using differs from that used by Vanessa.

Extended-response question

Marketing is essentially aimed at selling the goods and/or services of a business. Describe what is meant by the term 'marketing' and explain, with reference to the different types of markets, the different types of approaches to marketing that businesses may use to market their products.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

7 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 warranty
- price discrimination
- psychological factors
- sugging



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Psychological factors
The personal characteristics of individuals that influence their behaviour. These factors relate to the way people think and their attitudes.

7.1 Introduction

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.

7.2 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.

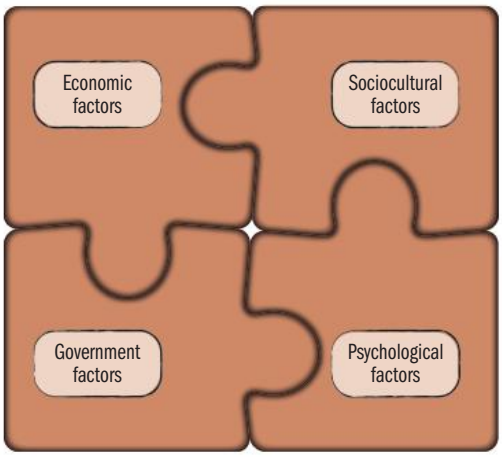
Psychological factors

Psychological factors are the personal characteristics of an individual that influence their behaviour. 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:

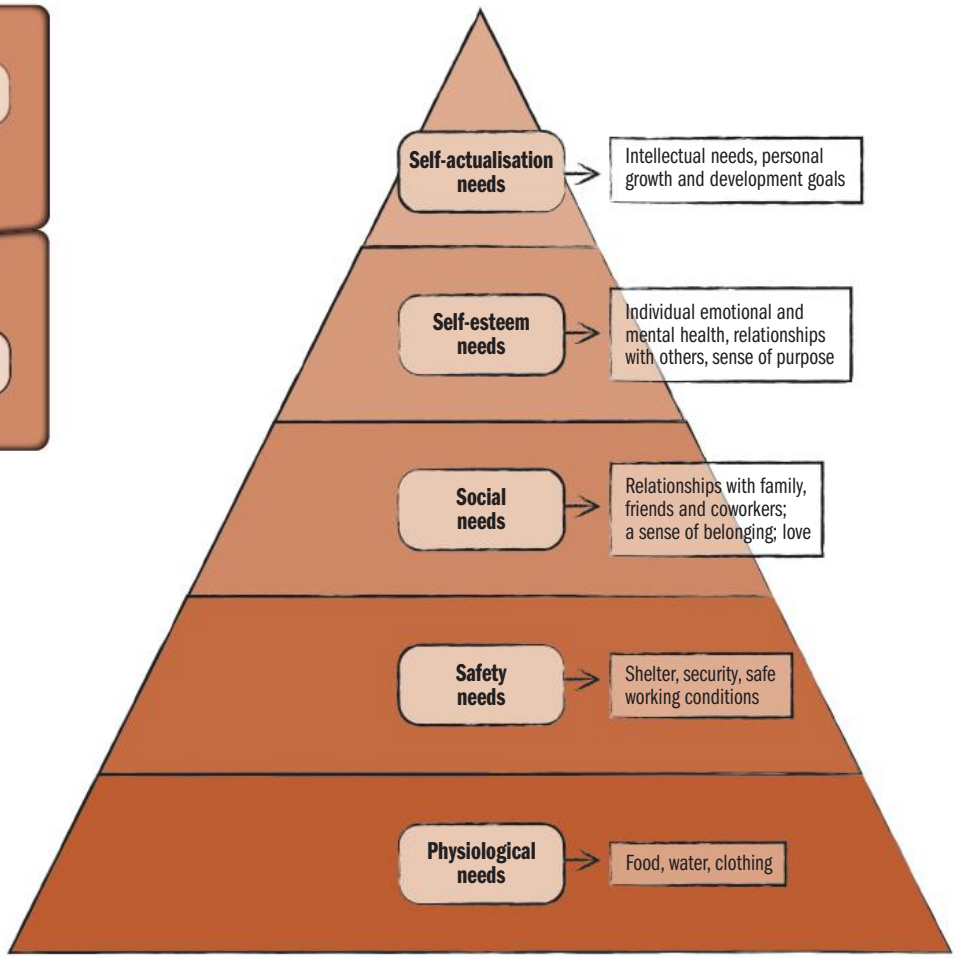
- motivation
- perception
- learning
- beliefs and attitudes
- lifestyle
- personality and self-concept.

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 7.2).



Source 7.1 Factors influencing consumer choice



Source 7.2 Maslow's hierarchy of needs

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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 issues, such as the consumer's ethnicity or religion. It is important that businesses 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. 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.

Business Bite

It started with two stores in Sydney in 2001, when an unknown German retailer entered the Australian grocery market. In less than 15 years, this retailer has become one of the most well-known low-cost quality brands in the country. With more than 6 million visits from Australian consumers each week, Aldi offers low prices on food items, cleaning products and weekly specials, enticing customers into the store.



Source 7.3 Aldi receives more than 6 million visits from Australian consumers 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

TripAdvisor is a leading worldwide travel website that allows travellers to share their experiences with others on airlines, hotels and tours across the world. Pictures from their holidaying experiences can also be uploaded, providing the consumer with greater information to base their purchase decisions on. However, the open nature of TripAdvisor, and the large number of posts it receives, makes it possible for companies to masquerade as customers and recommend their own products or give negative reviews to competitors. Although TripAdvisor has a fraud detection system, there have been many cases of unscrupulous companies having fake reviews posted.

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 his or her 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 7.4 Religious beliefs such as keeping kosher 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 consider 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 hiking, camping and outdoor activities may shop at stores like Kathmandu, The North Face and Uniqlo. Aligning a famous person with a brand can attract customers who like or admire that person. Taylor Swift is one of the world's leading musicians and entertainers and endorses Apple Music as part of the company's push into online music streaming. The advertisements feature Swift listening to Apple Music on her Beats by Dre headphones, another business owned by the American technology giant.



Source 7.5 Consumers are often thought to purchase products that reflect their personalities.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Sociocultural factors

Sociocultural influences on a customer's choices are those that come from the customer's society and culture. An example of a sociocultural factor is a consumer's place of residence. 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

Australia is a multicultural society that consists of consumers from a diverse range of ethnic backgrounds. This means some companies' policies must change to reflect the needs of consumers. Telstra has established a multicultural call centre, where customers across Australia can speak with a Telstra customer service representative in a range of languages other than English, including Cantonese, Arabic, Greek and Spanish. This initiative has proved to be incredibly valuable to consumers who do not speak English, or who are not comfortable doing so.



Source 7.6 Some customers find it easier if a call centre representative speaks a language other than English.

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 come from the 'A demographic'. 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. As such, 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

regulation takes place through the implementation of the government's fiscal and monetary policies and through microeconomic 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, for example, on the level of taxation consumers pay in the form of income tax and the goods and services tax (GST) on the purchase of goods and services.



Source 7.7 GST (goods and services tax)

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 business will access. Microeconomic reform is where the government makes policies to promote greater competition within a particular industry. It has proven 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. 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.

Business Bite

Australia has one of the most regulated markets in the world for the sale of tobacco. Along with strong visual images highlighting the dangers of smoking, tobacco must not be visible in a store and penalties apply to businesses selling the product to individuals aged under 18.



Source 7.8 Australia boasts one of the most regulated tobacco markets in the world.

Activity 7.1 Comprehension

1 Describe how an improvement in economic conditions could influence customers' buying behaviour.

2 Examine the importance of sociocultural factors in influencing customer choice.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

7.3 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 place of manufacture
- 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 unfair, deceptive and misleading behaviour, consumers are responsible for reporting such cases.



Source 7.9 Parliament House, Canberra: the Commonwealth government controls business behaviour through the *Competition and Consumer Act 2010* (Cth).

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Part V of the Act target specific types of trader behaviour:

- A business must have *reasonable* grounds when predicting future events. Businesses should consider, or adequately address, the range of uncertainties and variables involved (section 4). Example: an oven retailer falsely stating that their ovens were 'risk free' as they could be returned within 12 months if the buyer was not satisfied.
- Commercial conduct must not *mislead or deceive, or be likely to mislead or deceive*. This is a very broad provision (section 18). 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 (section 29). 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 (section 30). 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 (section 31). 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 (section 48). Example: a used car dealer advertising the price of a car as periodic repayments without stating the actual cash price of the vehicle.
- Businesses must not engage in conduct that *misleads or is likely to mislead* the public about the characteristics, suitability or quantity of services (section 34). 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 (section 37). 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 & Consumer Commission, *Advertising and Selling Guide*.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 7.2 Comprehension

1 Explain why deceptive and misleading advertising is considered to be unethical.

2 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. 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 an **implied 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. Most businesses offer a warranty of at least 12 months for electrical products and home appliances. Hyundai offers a five-year warranty on its cars. Warranties can be a very powerful marketing tool for a business to attract customers.

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*, a manufacturer cannot refuse to sell

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 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.

Source 7.10 American retailer L.L. Bean famously offered a lifetime guarantee.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Activity 7.3 Comprehension

1 Define what is meant by resale price maintenance.

2 Identify two examples of how a business may engage in deceptive and misleading advertising.

7.4 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.



Source 7.11 Truth in advertising is an essential component of business ethics.

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*. The Act prohibits a business from supplying goods that do not comply with prescribed product safety standards.

The Advertising Federation of Australia (AFA) works alongside the legislative framework. This is the peak body representing companies in advertising and marketing communications. The AFA seeks to promote best practice in advertising by members of the industry. This also includes compliance with the

Business Bite

The Advertising Standards Bureau (ASB) is a system that regulates what advertisements are allowed on television and the standards to which Australian advertising should be held. Although the industry is largely self-regulated, the ASB offers easily accessible avenues for consumers to submit thoughts and complaints regarding specific advertisements, and aims to resolve these issues fairly and respectfully. These complaints may revolve around decency, truth in advertising or politically motivated persuasion.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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. An individual's reaction to an advertisement may differ from that of another individual. United Colors of Benetton is a leading fashion house across the world. However, it uses somewhat controversial advertisements to promote social issues, while at the same time selling its brand name.

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.

Ethical spotlight 7.1

Should a fast-food restaurant be allowed use of logos endorsing its business as healthy? What impressions does this give of the business's menu across the board?

The Communications Council Code of Ethics

Ethics at work: a guide to marketing communications' grey areas

1. **Stand up for what you believe is right.** Be open-minded and receptive. If something's wrong, try to resolve it. Let a well-informed conscience be your guide.
2. **Honour all agreements.** Agreements are expressions of trust. Honour all promises – written or spoken – to clients, colleagues and suppliers. Respect confidentiality.
3. **Don't break the law. Don't bend the law.** Think beyond legal argument to moral argument – the spirit of the law. Don't stretch the truth. Don't look for loopholes.
4. **Respect all people.** No stereotypes please. Individuals should be understood, not portrayed in a way that could bring disrespect. Use humour, but avoid cheap shots.
5. **Strive for excellence in everything you do.** Create an open, trusting environment with colleagues, clients and suppliers. Raise the standards of creativity and professionalism.
6. **Give clients your best advice, without fear or favour.** Act in your clients' best interests. Tell them what they need to know, not what you think they want to hear.
7. **Look after your colleagues.** Responsibility is a two-way street. Look for the best in one another, acknowledge it, and reward it. Leave room for fun, family and friends.
8. **Compete fairly.** Be honest in commenting on competitors and our industry. No dirty tricks in new business. No misrepresentation of the capabilities of your business.
9. **Think before you act.** The best decisions are informed decisions. Think before you act. Will this action connect with your personal sense of what is right or wrong?
10. **Be honest.** This can be tough. Be honest without being brutal. Be true to yourself. Recognise the trust placed in you, your company and the marketing communications industry, then act accordingly.

If you stand for nothing, you'll fall for anything.

Source: The Communications Council, 'Ethics at Work'.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

The use of children often raises significant ethical issues around how they should be portrayed. Advertisers should balance the interests and safety of children with the intended interest in promoting a product. In 2016, US swimming costume label Hot as Hell used child models as part of its fashion show. Despite the business using environmentally friendly materials in the production of its swimwear, the business attracted significant publicity with some concerned social media users worrying that it leaves child models at risk. There are many who would consider this form of promotion to be unethical.

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, restrictions on tobacco sponsorship and entry into casinos.



Source 7.12 Entry into a casino in Australia is thought of as a demerit good.

Source 7.13 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 a Responsible Service of Alcohol
	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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

Business Bite

The ACCC keeps a close eye on petrol retailers in Australia in order to combat unfair inflation and price-fixing between big companies. In Cairns, the ACCC has entered into an investigation into fuel fixing, after prices averaged at approximately 130 cents per litre for unleaded petrol, with residents spending $300 more a year than people living in Melbourne. Although the government cannot impose petrol prices, it can encourage competitors into the market who may drive prices down.



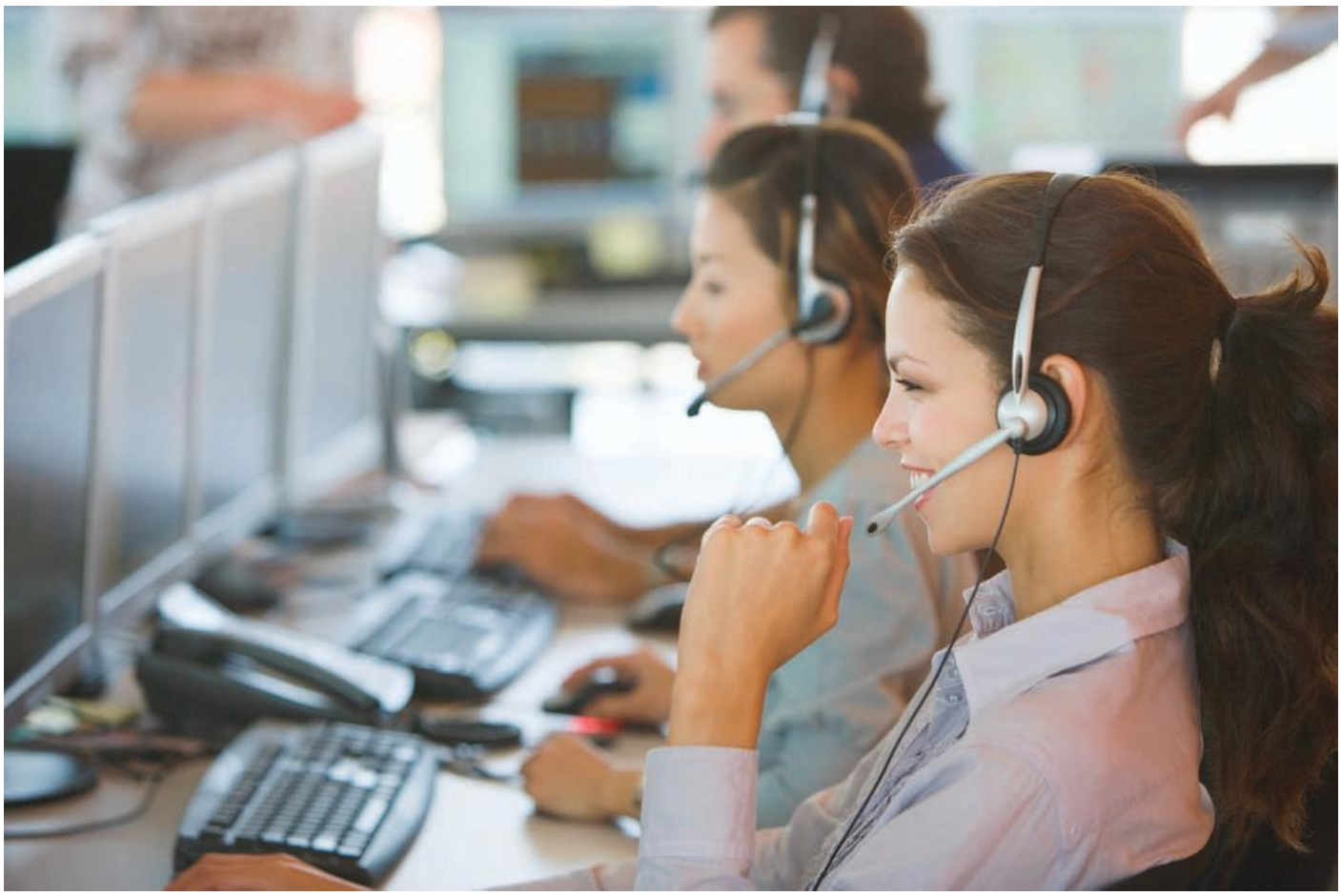
Source 7.14 The ACCC investigated fuel price-fixing.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 'Would you like to be a millionaire in two years?' 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.



Source 7.15 Sugging involves selling under the guise of research.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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*.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Which of the following scenarios best describes the practice of price discrimination?

A Smarta Electrics sells air conditioners to consumers located in different geographic areas at different prices.

B Sing Lee and Davie Jones each sell the same digital video camera but at different prices.

C Vision Central offers discounts to pensioners and to consumers willing to pay cash.

D The manufacturer of Toko cars sells the cars to different car dealerships at different prices.

2 Helen visits a furniture store hoping to purchase an outdoor setting that was advertised as being priced 'below cost'. When Helen asks the salesperson to show her the setting, she is told that there was only a very limited number and they were sold that morning. Helen is then shown a more expensive style of outdoor setting. This practice is typically known as:

A bait and switch advertising

B sugging

C retail price maintenance

D higher costs.

3 Ben's Pies is advertising its food products as '97% fat free'. Independent tests reveal the fat content is actually greater than this. Which of the following processes is the business engaging in?

A Deceptive advertising

B Price discrimination

C Taste in advertising

D Sugging

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

4 Psychological factors are reflected through which part of consumer behaviour?

A Their personality
B Their culture
C Their income
D Government policies

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 Hannan has applied to a religious council to receive approval for the ingredients of the products she uses in her food business. She believes this will allow her business to better cater to the religious needs of her customers. What factor has influenced Hannan's decision?

A Socioeconomic status
B Culture
C Income
D Learning

8 A consumer's decision to buy upmarket clothing brands would be influenced by which factor?

A Culture
B Personality and self-concept
C Government policy
D Motivation

9 The Reserve Bank of Australia has lowered interest rates as a way of encouraging consumers to increase their level of spending. Which government policy is this an example of?

A Monetary policy
B Fiscal policy
C Microeconomic reform
D Industry reform

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 Explain how socioeconomic and government factors influence a business's marketing plan during a downturn in economic activity.

2 Outline legal considerations for a business developing a marketing campaign.

Extended-response question

Identify the factors influencing consumer choice and examine the impact of ethical and legal regulations on the process of marketing of a product.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

8 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

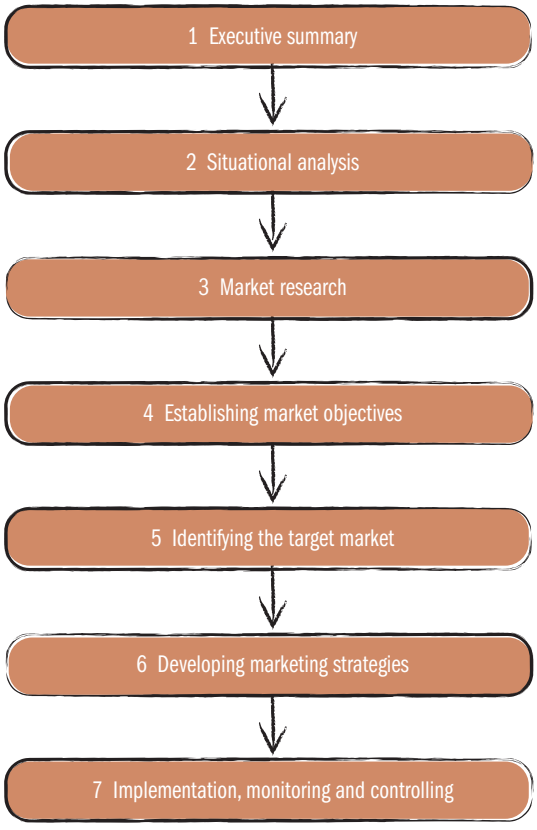
- market share analysis
- marketing profitability analysis
- primary data
- product analysis
- product life cycle
- sales analysis
- secondary data



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

8.1 Introduction

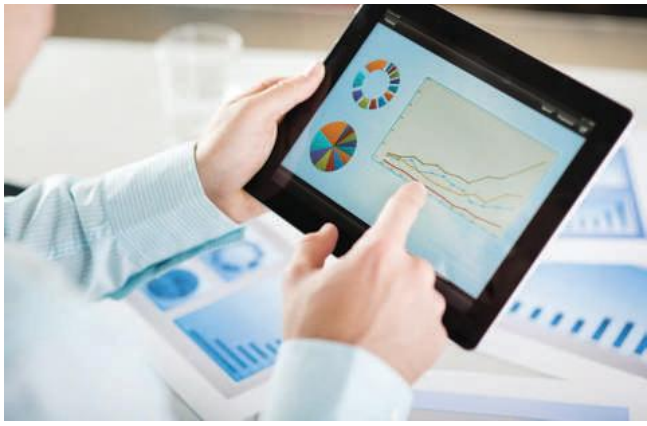
Planning is a central activity of any organisation. It allows a business to examine its current position within the market, consider opportunities to strengthen that position and determine the most effective method of implementing the required changes. This chapter examines the common elements involved 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 8.1. 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 8.1 The elements of a marketing plan

8.2 Executive summary

The executive summary provides a brief description of current issues facing the business. It provides an overview 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.



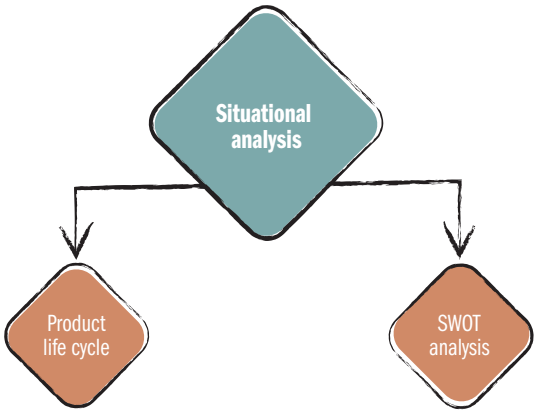
Source 8.2 The executive summary provides a brief description of current issues facing the business.

8.3 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 8.3 The two components of a situational analysis

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Product life cycle

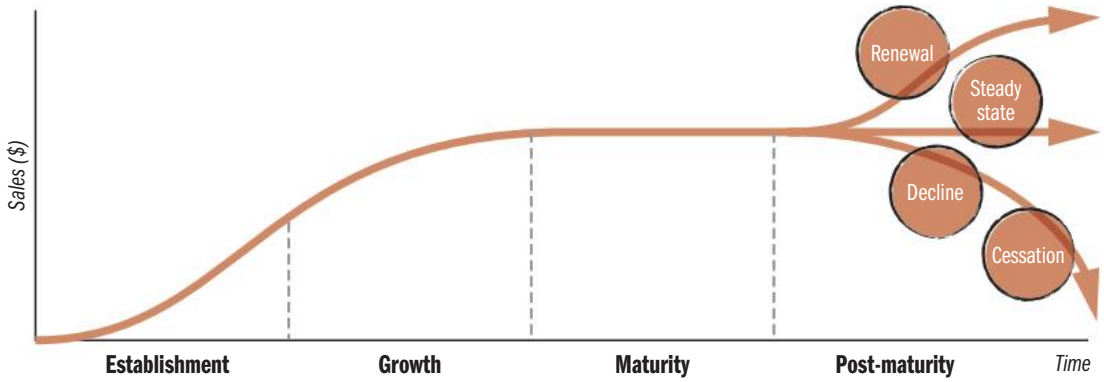
Product analysis examines the current position of the goods and/or services that a business produces in the marketplace. Changing trends, innovation, product prices, sales and profit margins will impact on the success of a product within the marketplace and this is something all businesses will experience. 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 8.4).

When looking at the product life cycle it is important to remember a key point: 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.

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 8.4 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.

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 9 in detail). Aldi has been successful through the use of this pricing strategy. Since its establishment in 2001, the grocery store has heavily promoted itself on its low-cost items. It now accounts for more than 15 per cent of grocery sales in Australia.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

In recent years, budget-price video streaming has become a massive phenomenon in the home entertainment market in Australia. Subscription-service Foxtel was once seen to have a virtual monopoly on this market until major US player Netflix was released in 2015. Before it arrived in Australia, Foxtel pre-emptively halved its basic package rate per month in order to combat the predicted success of Netflix. According to Roy Morgan research, by mid-2016 some 1.9 million households subscribed to Netflix, while competitor Stan had around 332 000 Australian subscribers. Though the success of Netflix cannot be denied, *Business Insider Australia* reported that in the first half of 2016 Foxtel's subscribers actually grew from 2.6 to 2.9 million – suggesting that competition in the video streaming sector is alive and well, and that Foxtel's business decision to cut its subscriber fees may have been a masterstroke.



Source 8.5 Video streaming is increasingly popular in Australian homes.

Maturity stage

The maturity stage is the period of the product life cycle when sales will begin to slow. 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.



Source 8.6 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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 8.1

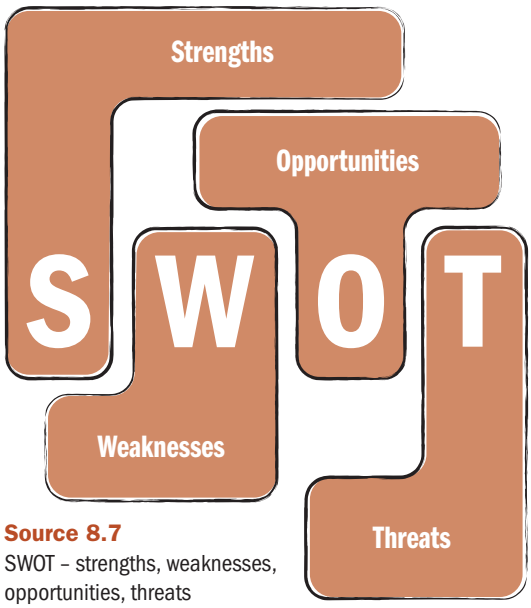
Should a business make use of strategies similar to those of its competitors if it found they were more successful than those the business is using?

Business Bite

Beginning in Michigan, United States in 1971, Borders bookstores was one of the leading chain booksellers in the world. However, after the chain failed to keep up with the emergence of online booksellers and could not stay profitable, it steadily declined. The last Borders bookstore in Australia closed in 2011.

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 what strategies would be suitable to rectify the organisation's weaknesses and how to best handle the possible opportunities and threats.



Source 8.7
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 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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?

Activity 8.1 Comprehension

1 Examine how a SWOT analysis helps a business to consider its current position within the marketplace.

2 Identify a large business with Australian-based operations and complete a SWOT analysis for this business.

3 Discuss how the different stages of the product life cycle influence a business's choice of marketing strategies.



Source 8.8 Businesses must remain aware of threats from the external business environment, such as less expensive substitutes.

Primary data Information that is collected for the specific purpose for which it will be used.

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.

8.4 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.

Data collection (primary and secondary)

There are two types of data that an organisation may seek to gather: primary and secondary.

Primary data

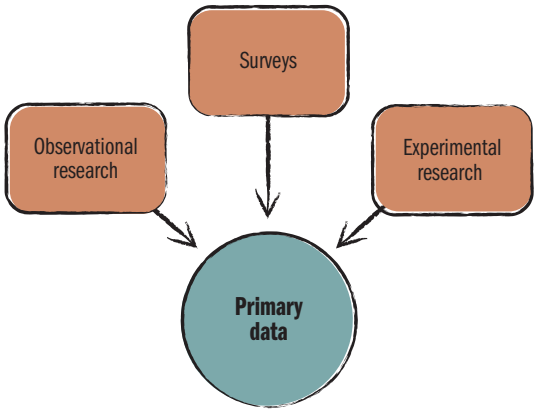
Primary data refers to information that is collected for the specific purpose for which it will be used. For example, if Myer conducted research to determine the age bracket of its customers visiting a specific store, the data it gathered would be primary data. It would be primary data because it was gathered only to fulfil the specific purpose of the research; that is, to find out the age profile of Myer customers.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 8.9 Research on the age bracket of shoppers provides primary data.

There are three common types of market research that can be used to collect primary data – observational research, surveys and experimental research.



Source 8.10 Types of market research used to gather primary data

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.

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 already been collected for another purpose. Myer, 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.

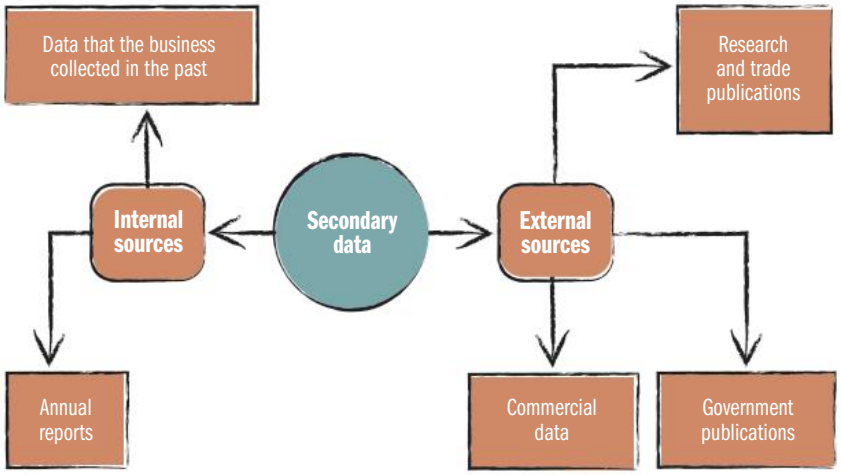
Secondary data
Information that already exists, having already been collected for another purpose.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 8.11 Sources of secondary data, with examples

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.

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.

Business Bite

The success of Network Ten's *MasterChef Australia* has seen consumers taking a more active and informed interest in food-based television programs. In response to this, Channel Seven created *My Kitchen Rules*. This family-friendly program has achieved extraordinary ratings. Changing circumstances in the businesses' external environments meant that new objectives were set and strategies established for each network.

Activity 8.2 Comprehension and research

1 Outline the difference between primary and secondary data.

2 Develop a survey based on the shopping habits of your Business Studies class. The survey questions should consider:

- the types of shops visited
- the reasons for visiting specific stores
- how often the student would visit the store.

3 Once you have completed the survey, you could:

a display your survey results in a bar graph

b examine current promotional material from the businesses identified by your class, and consider their effectiveness in reaching the businesses' desired target markets.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

8.5 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.

General market objectives

There are three general market 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 profitability.

Achieving this objective allows the business to become stronger and more dominant in the marketplace. Aldi, which offers low everyday prices and emphasises value for money, is now recognised as a significant force in the Australian grocery market. It has expanded into fruit, vegetables and the sale of alcohol. Aldi now has 400 stores across Australia, although it is dwarfed by the combined 1800 stores of Coles and Woolworths.



Source 8.12 Coles and Woolworths dominate the Australian grocery market despite international competitors.

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 an increased number of customers. In recent years, Australia has seen a considerable growth in the number of international fashion boutiques. For example, Spanish fashion brand Zara opened up in Sydney in 2011. Zara is perceived by many young adults as having contemporary clothing at affordable prices. Zara's Sydney store was the first of its kind in the Pacific. This was a new geographic market for this firm.



Source 8.13 Zara is one of the international retail giants that has opened stores in Australia.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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. Unilever, for example, has two similar beauty product brands: Dove and Lux. Each brand is aimed at a different target market. The business develops, promotes and distributes both brands in order to establish a broad customer base.



Source 8.14 The Coca-Cola company has a wide variety of products to ensure a broad customer base.

Activity 8.3 Matching

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	Provide a wider range of products to target new markets in order to attract consumers who have not previously purchased its brands
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

8.6 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, Myer and David Jones act as the market where consumers can access these brands.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 8.15 Some products appeal to all consumers, while others, such as this man's hat, may have very limited appeal.

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 both genders and of all 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 the offer of customer loyalty products. 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 a particular market. A business can decide to segment its market to ensure that appropriate promotional and pricing strategies are developed.

Business Bite

Sydney radio station KIIS 106.5FM was launched in January 2014 and has been highly successful in targeting the 25–44 years female demographic. Its timeslots are customised to the subgroups within that demographic who listen to the radio at different times:

- ***Kyle & Jackie O*** **in the breakfast slot (weekdays from 6 a.m.) delivers a combination of celebrity news, gossip and fun. Already established on radio, the pair brought a fan base with them when they moved to KIIS 106.5.**
- ***The 3PM Pick Up*** **specifically targets mothers driving to collect their children from school. The emphasis is on the 'now' – what is happening for listeners, for the hosts, in the news and in the world of entertainment.**
- ***Hughesy & Kate*** **is for listeners driving home from work, and offers lively and entertaining discussion covering a range of personal and offbeat topics.**
- ***Kyle & Jackie O Weeknights*** **sees the breakfast hosts returning for more gossip, fun and celebrity news.**
- ***The Thinkergirls*** **is very focused on the female demographic. Starting out as a podcast, this duo already had a cult following before joining KIIS in January 2016.**



Source 8.16 Kyle and Jackie O

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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, Fernwood gyms were established to cater for the growing number of women who sought female-only gymnasium facilities.

Wedderburn is an international business with Australian operations. The business specialises in the production and sale of scales. These scales are used by other businesses to weigh such items as foods and medicines. Other examples of targeting niche markets include travel agents specialising in services to specific regions and magazines for specific hobby enthusiasts.

Activity 8.4
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.

8.7 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 9.

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.



Source 8.17 Prices inform the consumer about the product and company.

Promotion

Promotion is the process of creating and maintaining consumer awareness of, and interest in, a particular product. It is hoped that the various forms of

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 the use of mobile phone text messages, the internet and publicity stunts.

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.

Activity 8.5
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.

8.8 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 determine 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 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.



Source 8.18 A business can monitor and control the effectiveness of its marketing through methods such as sales analysis.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

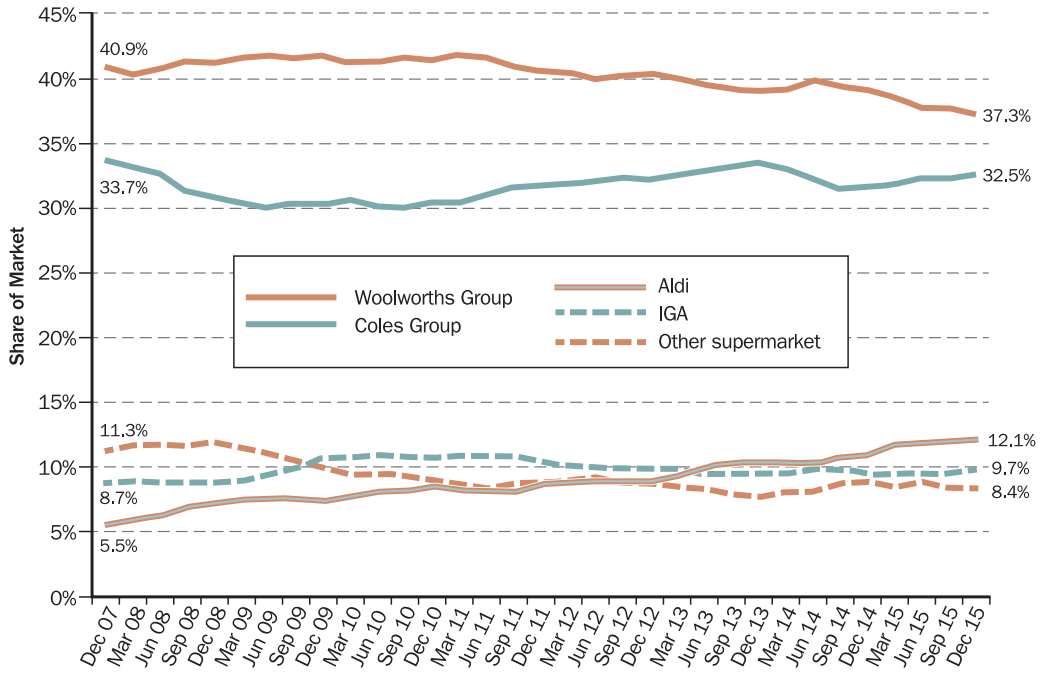
Sales analysis

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 the business have increased the number of customers the business has and the extent to which these customers have come from



Source: Roy Morgan Single Source (Australia), January 2007–December 2015, average 12-month sample = 14,793. Base: Australian grocery buyers 14+, weighted to households.

Source 8.19 Market share of Australian supermarkets

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Business Bite

Seasonal issues often impact upon the performance of a business and, as a result, marketing strategies must change. For example, in 2016 the early winter period was warmer than usual in Australia. Retailers such as Myer, who had filled their shelves with winter products, reported reduced sales as customers proved to be less interested in purchasing during the continuing autumnal weather. However, some other retailers take a different approach to the winter season in Australia, recognising that it is a much shorter period than in European countries. For example, Kmart used to bring in its winter stock in February, but now waits until April and May.

Activity 8.6 Discussion

1. Discuss the purpose of a business developing a financial forecast before implementing its marketing strategies.
2. Propose two reasons why a business may consider revising its marketing plan.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

Tonad Consulting has provided you with a summary of its report to the owners of Arabia, a well-known Middle Eastern restaurant located on Sydney's northern beaches. The summary is given below. Read the summary and then answer the questions that follow.

Arabia is one of the northern beaches' most respected eateries. It is held in high regard for the quality of its food and the outstanding service it provides. Its client base, 30–45-year-old females, tends to be very loyal.

Rising rental costs have forced the owners of the restaurant to consider increasing the price of all main meals. They are showing some hesitation in doing this, as a newly established competitor in the area has been successful in attracting a more diverse group of customers to its restaurant.

It is recommended by our consulting firm that Arabia use local-based advertising to generate increased awareness of its outstanding products and service. It is very likely that the rising rents will force an increase in prices. However, we believe that when more consumers become aware of the business, Arabia will benefit through increased revenue.

1 Identify which stage of the product life cycle Arabia is in.

2 Discuss two strengths of Arabia.

3 Identify the name given to the type of market Arabia has targeted.

4 Identify two threats facing Arabia.

5 Recall the name given to the customer group of Arabia's competitor.

6 Outline two marketing strategies that the consulting firm recommends Arabia use.

7 Explain the market objective the consulting firm best believes the restaurant should pursue.

Multiple-choice questions

1 Painaway is a recognised and trusted form of minor pain-relief medication. In a SWOT analysis, what would Painaway's reputation be considered to be?

A A strength
B A weakness
C An opportunity
D A threat

2 Due to heavy discounting and changes in people's travel patterns, a budget motel has ceased trading. Which stage of the product life cycle is the business presently in?

A Establishment
B Growth
C Post-maturity – decline
D Post-maturity – renewal

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Better Bread has released a new form of bread aimed at children. Which word best describes the market to which this product is targeted?

A Consumer
B Mass
C Differentiated
D Niche

7 *Antonietta* is a new magazine aimed at young adults who display an interest in cooking. To which type of market is this product being targeted?

A Micro
B Niche
C Concentrated
D Segment

8 Market objectives can, at best, guide the operations of a business but cannot dictate its actual progress. What would be the best reason for this?

A A business may lack the human and financial resources necessary to achieve the objectives.
B Any business is subject to the forces of its external environment, which can easily impact on the operations of the business.
C Management may decide to review the marketing plan and alter any strategies that it regards as ineffective.
D Market objectives tend to have a short-term time frame and therefore are in constant need of change.

9 What is market research?

A The process of examining market trends and their impact on the operations of a business
B The study of consumers' buying behaviour
C A process of gathering information relevant to the needs of the business and those of its clients
D The study of the operations and practices of a business's competitors

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 a Explain what is meant by a situational analysis.

b Describe the four key elements of a situational analysis.

2 a Outline the different types of target markets that exist in the consumer market.

b Provide examples of businesses appropriate to each market.

Extended-response question

Helen's is an upmarket fashion boutique store in Sydney's east. Falling sales have been reflected by surveys that reveal consumers' views of the business as outdated and no longer relevant to consumers' needs. Strong competition in the area has placed considerable pressure on pricing. The business's target market, 50–65-year-old females, no longer dominates the now younger demographic character of the area.

Develop a marketing plan for the business that suggests how Helen's may improve its performance.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

9 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
- market skimming
- penetration pricing
- place
- positioning
- price
- product-deletion pricing
- psychographic segmentation
- relationship marketing
- selective distribution

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

9.1 Introduction

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 that have equal importance, so now we work in terms of the 7Ps, with the additional three being people, processes and physical evidence.

Market segmentation The process of breaking down a total market into small markets based on the similar characteristics of a customer group.

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.

9.2 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 breaking down a total market into a market based on the similar characteristics of a customer group. 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.

Geographic

Geographic segmentation is the process of dividing a market or customer group into smaller markets based on different geographic locations, such as nations,

Source 9.1 Only a limited number of products appeal to all consumers, such as electricity, gas, rail services and postal services.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 9.2 McDonald's India does not use any beef products.

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 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.



Source 9.3 Some products are marketed to appeal to specific age groups.

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.

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. *Total Girl* is an Australian-based magazine that caters to the interests of the female tween market, representing girls aged 9 to 13. Young adult females may read *Cosmopolitan*.

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.

Demographic segmentation The process of dividing a market into smaller markets based on customers' age, gender, income, family size and level of education.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

Many brands use marketing techniques to target the same product to different market segments with great success. The most common example of this is toiletries. Nivea identifies three main market segments in its product range: women, men and children. There is no biological or physical difference between men's and women's need for skin care products, and no health-related reason to buy gender-specific products. Yet Nivea, like almost all skin-care companies, markets the same or similar products to different genders in order to increase sales. Different colour schemes, scents, packaging and descriptions of these products are used to appeal to different markets.

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



Chanel is one of the world's leading fashion and beauty brands. Its products – including clothing, fragrances, skin care, make-up and accessories – are aimed at individuals with a high income. Chanel stores are located in Sydney's central business district and eastern suburbs. These areas are distinguished by the high average income and socioeconomic status of the consumers who shop there.

Source 9.4 Chanel markets towards high-income customers.

Psychographic segmentation The process of dividing a market into smaller markets based on consumers' lifestyles, personalities, values and interests.

Psychographic

Psychographic segmentation allows a business to segment the market into different groups based on consumers' lifestyles, personalities, values and interests. For example, sporting equipment retailers (such as Rebel) divide their stores into sections based on different sports. Part of a store will specialise in cricket clothing, while another section is for gym enthusiasts, and another caters for people with outdoor leisure pursuits. The store layout reflects the community's wide range of sporting interests.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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 the different classes of airline seats. Passengers who may prefer greater comfort, access to gourmet menus and priority check-in may choose to fly business or first class.

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. Mobile phone companies have adopted this strategy by offering different groups of consumers different internet packages, depending on their phone and data/internet usage requirements.

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. Credit card rewards schemes and the Woolworths Rewards card are examples of such strategies.

Behavioural segmentation
The process of dividing a market based on people's knowledge of, attitudes towards and use of a product.

Activity 9.1 Summarise

Construct a diagram that summarises the methods that a business may use for segmenting consumer markets. Include examples of products that businesses have used to segment their markets.

Source 9.5 First-class airline seats offer greater comfort.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

9.3 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

Price The cost to the consumer of buying a good or service.

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. Kmart has been highly successful in using this strategy to differentiate itself from its competitors. This is reflected in its slogan: 'Great value and everyday low prices'. Some businesses will use a business name that emphasises price differentiation. Budget Rent a Car and Supercheap Auto are two such examples.

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, Woolworths uses the slogan 'Australia's Fresh Food People', while BMW distinguishes its cars as 'The Ultimate Driving Machine'.

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.



Source 9.6 BMW's slogan, 'The Ultimate Driving Machine', denotes the expectation of quality goods.

Business Bite

Hyundai offers its customers an unlimited-kilometre five-year warranty on all its new cars. This is one of the few car companies in Australia to do so and is in addition to the three years offered by most other motor vehicle companies in the Australian market.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

9.4 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. Crust Pizza, for example, provides consumers with a food product, while mobile mechanics, Lube Mobile, offers a car repair and maintenance service. 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 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, he or she is 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 manufacturers. 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.

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 9.7 Brand packaging is the first interaction the consumer will have with a product.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

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.

Activity 9.2 Discussion

Conduct a group or class discussion on the topic: 'Consumers are swayed more by the packaging of a product; hence, some people's reluctance to purchase generic brands. Consumers can, at times, be more interested in how a product looks than in how it works'.

9.5 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

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 encouragement 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.

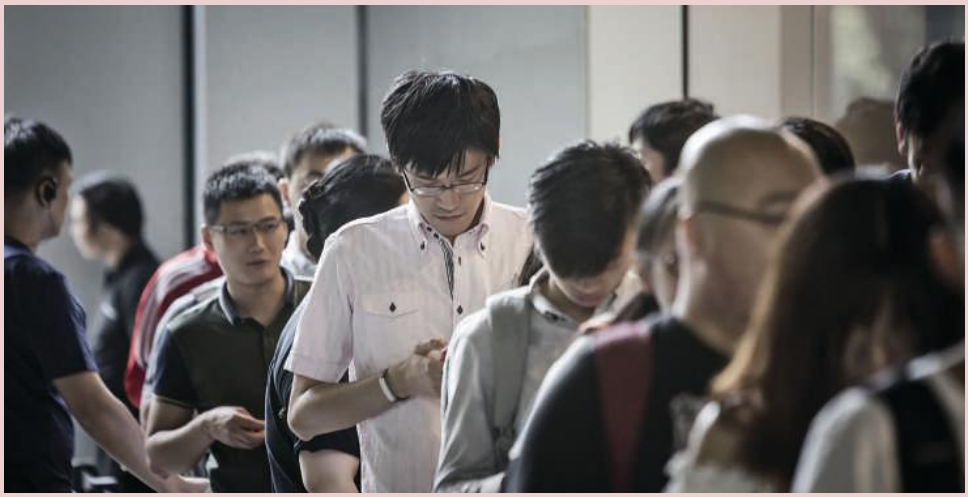
Strategies to achieve the greatest financial return include:

- *Market 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 **market 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.
- *Demand-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 demand-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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

Apple uses market skimming as a pricing strategy. The release of its new products is accompanied by high prices. This in part reflects the level of quality in the product, the extent of research and development in the product's creation, and the prestige associated with owning the product.



Source 9.8 Customers line up for the iPhone 7 and Apple Watch Series 2 release.

- *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. Motor vehicle companies such as Porsche and Ferrari 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.
- *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. Examples would include offering business users lower weekday costs for a mobile phone, while consumers are offered promotional features, such as free message services and reduced weekend call rates.
- *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.

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 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 experienced financial advisers and medical specialists, for example.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 9.3 Analysis

For each of the situations described below, identify the pricing strategy used by the business.

1. Longstar Air has entered the Australian domestic market with prices much lower than those of its competitors.
2. Big T is selling its televisions at cost price to encourage consumers to visit its stores and become more aware of its range of DVD recorders.
3. Samir has received a discount for making a bulk purchase of timber from Harry's Hardware.
4. Josephine Watches have an exclusive image and, therefore, are sold at a considerably higher price than watches sold by a competitor with a less upmarket image.
5. Eastside Bank has lowered its fees because of a fall in the number of new customer accounts being opened.
6. Textafone has established different pricing rates for its various mobile phone packages.

9.6 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 9.9 A sales party for jewellery

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 are discussed below.

- *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 now a popular method of selling due to the range of products that can be sold. No longer are these parties restricted to mainly middle-aged women being shown displays of plastic kitchen appliances or make-up. Party plans selling jewellery, clothing, toys, plants and scrapbooking supplies are increasing in popularity. A recent development is businesses using social media to promote their products 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. This word-of-mouth style of personal selling is referred to as whisper marketing.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- *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 now 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 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.

  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.

Relationship marketing
The process of building and maintaining long-term relationships with customers.

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.

Ethical spotlight 9.1

Suggestive promotions are used to attract the attention of consumers. They generate awareness and interest. 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. 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 9.4 Research

Choose an advertisement in a magazine or newspaper and answer the following questions.

1. Identify the name of the business/product being advertised.
2. Assess who you think is the target market for this business/product.
3. Classify what form of market segmentation the business used to establish this target market.
4. Distinguish if this advertisement is an unconventional or new form of advertising.
5. Evaluate how effective you think this advertisement is in appealing to its target market.

9.7 Place/distribution

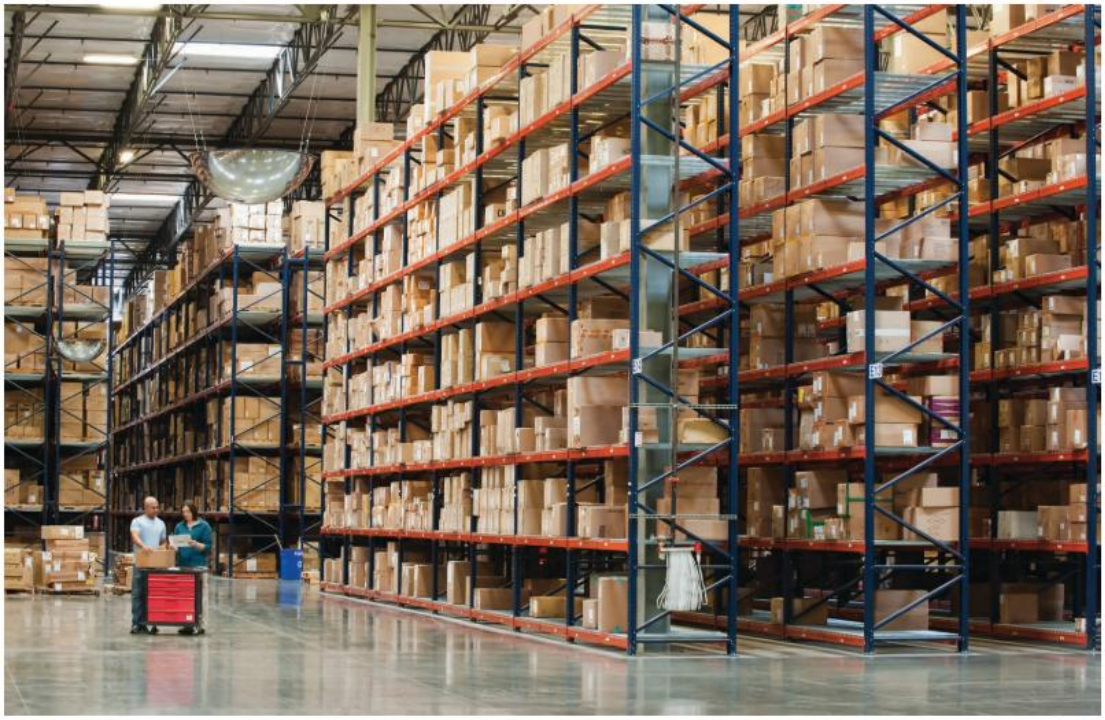
Place The methods of distribution and availability of a good from different outlets and locations.

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).

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

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



Source 9.10 Distribution channel: producer to wholesaler to retailer to consumer

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 the buying patterns and behaviour of 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 takes responsibility for distributing the product from the producer to the 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. Cue is a ladies fashion brand available at a limited number of Cue stores and also across all Myer 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. Tiffany & Co. is one of the world's most exclusive lines of jewellery. The jewellery it designs and manufactures is only available in Australia from six stores. Each of those stores is located in close proximity to customers with a high income.

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 9.11 Tiffany & Co. stores are located in high-income areas.

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.

Intensive distribution Occurs when a product is readily available to a wide selection of businesses or locations.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- *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.

Source 9.12 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.

Activity 9.5 Comprehension

1 Distribution channels can be categorised as intensive, selective and exclusive. Describe these three ways in which a business may sell its products to consumers.

2 Explain why a business should consider transport and warehousing issues in determining the most appropriate form of physical distribution for its products.

9.8 People, process and physical evidence

In recent times, 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, and not just the four that we discussed earlier. The three additional Ps are people, process and physical evidence (packaging). Adding these three aspects to the marketing mix, we now have 7Ps.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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. 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.

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 with an 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 football clubs across New South Wales lost significant amounts of sponsorship, as businesses no longer sought to have their image associated with the negative publicity that the football clubs were attracting.



Source 9.13 Excellent customer service is an important element for a business seeking to maintain high levels of customer satisfaction.

9.9 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.

E-marketing is now the fastest-growing sales medium in Australia. It caters to a diverse group of customers, who range from 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 9.14 E-marketing is a key component of online trading, as is the need to ensure that online purchases are made securely.

9.10 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. Our needs and wants are influenced by such things as culture, income and standard of living. As such, 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, then 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. Nike 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, McDonald's has slightly different 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.

Activity 9.6 Comprehension

1 Explain the importance of primary market research for a global business.

2 Summarise global branding and what difficulties in marketing a global business may experience with branding.

3 Outline the financial benefits to a global business of standardisation of its product.

4 Under what market circumstances will a global business need to differentiate its product?

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, before a competitor can copy the product or service.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

Coca-Cola first entered the Chinese market in 1927, and Chinese employees tried to create an equivalent name for the Coca-Cola trademark, in Chinese characters. While conducting their research, they came across transliterations adopted by shopkeepers that translated to 'female horse fastened with wax' and 'bite the wax tadpole'. These were phonetic equivalents of 'Coca-Cola', and the shopkeepers had ignored the meaning of the characters. However, the employees could not do this. The closest Mandarin equivalent was found to be 'K'o K'ou K'o Lê', a combination of characters that translates as 'to permit mouth to be able to rejoice', which was fortunately a fitting definition.

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.



Source 9.15 Pokémon has retained its Japanese name in Australia.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

obvious impact here by creating 24-hour shopping with the convenience of never leaving 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 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.

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.

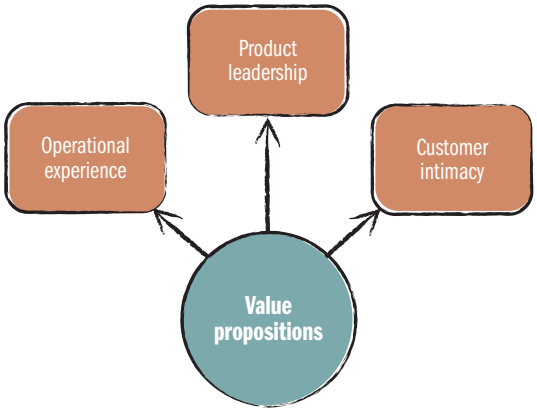
When customers are able to clearly see the manner in which a business differentiates itself and how it is different from its competitors, it becomes much easier for the business to highlight key points of difference. Without differentiation a business would require more time and money to develop customer 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.

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.

Business Bite

Coles flybuys and Woolworths Rewards cards are key drivers in each business's push to become more intimate with its customers. While consumers are swayed by offers of various promotions by scanning their rewards cards, what they are in fact doing is providing Coles and Woolworths with detailed insights into their shopping habits. The companies can then email customers targeted promotions based on their purchasing history.

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.



Source 9.16 Competitive positioning: value propositions

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 Rewards cardholders a notice of specials that may interest them, based on their shopping records).

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

Aldi opened the first of its Australian stores in 2001. Since then, the business has opened more than 400 stores across New South Wales, the Australian Capital Territory, Queensland and Victoria. Aldi believes that a key component of offering low-cost grocery items is based on achieving operational excellence. The store has adopted the following key features to clearly differentiate itself from its competitors in the Australian grocery market:

- **Most brands are developed through suppliers who then package the product as an Aldi brand. As a result, consumers do not have to pay for high advertising costs that are often included in the price of well-known and more trusted brands.**
- **Each store has limited staff on each shift, with normally two check-out lanes operating at a time. This reduces the need for staff, lowering the costs to the business.**
- **Trolleys must be returned to the trolley bay for the customer to be refunded their coin.**

Activity 9.7 Research

Research some of the great international marketing errors that have occurred. What other 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.



Source 9.17 The Chinese equivalent of the Coca Cola trademark

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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, multiple-unit pricing, market skimming, demand-based pricing, prestige pricing and psychological pricing.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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, processes and physical evidence into the marketing mix:

- 'people' refers to the conduct and performance of employees
- 'processes' 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Examples. Match each keyword with the correct definition and examples.

Keywords

- Market segmentation
- Demographic
- Marketing mix
- Branding
- Penetration pricing
- Market skimming
- Above the line
- Word-of-mouth
- Place
- Intensive distribution

Definition

- 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.
- Antonio spoke highly of his visit to a health resort.
- Cherie's Chewies 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.
- Air Blue has entered the Australian airline market offering prices much lower than those of its competitors.
- Samdak has released a new computer technology 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 2TN plays music from the 1980s and 1990s aimed at older female listeners.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Multiple-choice questions

1 SuperFizz has released a new soft drink targeted at women aged 18 to 39 years. Which form of market segmentation is SuperFizz using?

A Demographic
B Geographic
C Psychological
D Behavioural

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 lining
C Market skimming
D Competitive pricing

4 Which of the following examples represents the pricing strategy of market skimming?

A Tonasonic releases a new Smart TV that is unlike any of its competitors' products and it is priced very low to quickly establish a market share.
B Jetfly Airlines has reduced its prices as a result of its competitors lowering their prices.
C Hannah introduces a buy-one-get-one-free promotion for her café's new lunch menu.
D Red Star Medical has released a new form of medicine to relieve chronic arthritis and, in order to recover the research and development costs, the business is charging a high price for the product.

5 What is meant by the position of a product?

A The image of the product in the mind of the consumer
B The location of the product in retail stores
C The image of the product against its competitors
D The location of the product in wholesale stores

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 Nadton Motors has decided to use a popular racing car driver to promote the quality and value of its range of motor vehicles. Which element of the marketing mix is being used?

A Product
B Price
C Promotion
D Place

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

9 Ace-Pop is a healthy soft drink–style beverage. Its manufacturer has decided to first sell the product only at health food stores around the country. Which form of distribution is being used?

A Intensive
B Selective
C Exclusive
D Mass

10 What are global brands?

A They are logos that are easily recognised in different languages.
B They are the products that are sold worldwide.
C They are the name used to identify a range of products worldwide.
D They are a method of promotion used in different countries by the same business.

Short-answer questions

1 a Define the term 'market segmentation'.

b Outline the four key methods used by businesses to segment consumer markets.

2 a Explain the role of product in the marketing mix.

b How do businesses use different elements of the product strategy in their marketing mix?

Extended-response question

Market segmentation serves a considerable purpose for the operations of a business. Outline the benefits that market segmentation offers a business and describe, using examples, how businesses use market segmentation to target particular consumer groups.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

10 Marketing at Domino's



Chapter objectives

In this chapter, students will:

- investigate the role of marketing at Domino's
- evaluate the factors influencing customer choice in relation to Domino's
- examine Domino's marketing strategies.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

10.1 Role of marketing

Domino's has achieved a market share of 50 per cent of the fast service pizza market. This has been supported by a diverse product range that includes traditional pizzas, a healthy choice range, chicken wings and desserts. Business growth is expected to increase 35 per cent over the next year.

The marketing function at Domino's is spearheaded by Group Chief Marketing Officer Allan Collins, who joined Domino's as Chief Marketing Officer in 2007 and is now the major marketing strategist for Domino's in Australia, New Zealand, Belgium, France, Netherlands, Japan and Germany. In 2013, *CEO Magazine* recognised his achievements with its Marketing Executive of the Year award.

Within Australia, there are five divisions reporting to the National Marketing Director: Promotions, Communications, Digital, Product Development, and Product and Sales Analysis.

Strategic role of marketing

Profit is the key goal for all businesses. A business aims to deliver reliable and enhanced value that outperforms its competitors. By analysing and implementing growth opportunities, the business can establish strategies for advancement and evaluation of the competitive landscape. Strategic marketing enables a company to successfully distinguish itself from the competition.

Much of the recent success of the Domino's brand can be attributed to the company's marketing department, which is first rate. In 2016, Domino's increased its profit by more than 45 per cent, with same-store sales growth of 14.8 per cent.

It is thought that one contributing factor to Domino's growth was the decline of Eagle Boys Pizza. An IBISWorld report noted that one of the concerns raised by Eagle Boys Pizza franchisees was that their head office had not provided enough marketing support, which made it difficult for them to compete with the larger chains. By contrast, the Domino's marketing team is a key element in the ongoing support its franchisees receive.

Other drivers for the increase in profits include strong pricing strategies, digital innovation such as the interactive Pizza Mogul platform and the release of new pizza toppings including pulled beef and chicken.

Interdependence with other business functions

In Chapters 5, 15 and 21 of this textbook, the roles and interdependence of marketing with other key business functions – operations, finance and human resources – are examined in relation to Domino's.

Operations

There is a strong interdependence between marketing and operations due to the fact that the marketing message or the 'promise' is fulfilled by operations.

Finance

Domino's remarkable growth over the past couple of years has been largely driven by organic growth, acquisitions and first-to-market innovation. Part of its financial success can be attributed to the launch of a range of disruptive digital initiatives such as the market-first Project 3-10, 15/20 Minute Service Guarantees, On Time Cooking and Domino's Robotic Unit (DRU). These all contributed towards a strong Australia/New Zealand online sales growth of 33 per cent year-on-year.

Human resources

Domino's understands that its staff are integral to the success of the business. Its mantra is 'People Powered Pizza', and it knows that it couldn't be as successful as it is without the hard work and passion of its staff, from the in-store team members on the make line to the delivery experts out on the road.



Source 10.1 All staff are integral to the success of the Domino's business.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Franchisees

As a franchise business, Domino's offers support to its franchisees in a range of areas, including marketing.

It has a national Adfund to which all franchisees contribute. These contributions go towards the following areas:

Communications and PR

- Generating a positive local and National presence
- Public relations support to Franchisees

Online digital

- Domino's website
- Online ordering
- E-recruitment website
- Search engine marketing and search engine optimisation
- Social media development and management
- Social media communication: Facebook, YouTube, Twitter, Google Plus, Instagram

Advertising

- TV advertising
- Outdoor advertising e.g. Billboards, Bus Signage, Posters etc.
- Radio advertising

Production and print

- POS (point of sale) material
- Local store marketing (LSM) production, print and distributions
- Box topper flyers – production and print

On a local level, franchisees are expected to undertake additional local marketing including doughraisers, sponsorship and supplementary box topper flyer distribution.

Production, selling and marketing approaches

Domino's has made effective use of the marketing approach. This is evident in its outstanding financial results.

Its products and pricing reflect the interests of its customer base. Pizzas are diverse and encompass many flavours. Standard pizzas start at $13.90 and have wide appeal to all types of consumers. Domino's has recognised that consumers are seeking healthier choices and now seafood pizzas starting at $16.90.

Types of markets



It is the consumer market that generates the profit for pizza-based businesses. Thus, Domino's marketing is targeted at the mass consumer market.

Age, gender, income level, location and occupation are not key target areas for Domino's. This has been a considerable change for the business. When it first entered the market, its low-cost pricing strategy was aimed at customers seeking to take advantage of savings. However, this didn't give Domino's any point of difference with other fast-food and pizza outlets. Once the 'low-price' offering was not a priority, and the potential of technology to improve the quality and service of the product was realised, the Domino's business achieved incredible sales growth.

Domino's has diversified into gourmet-style pizzas along with its traditional pizzas, thus broadening the scope of its market. It offers all types of consumers a choice of products and variety. For example, the Chef's Best range of restaurant-quality pizzas was introduced as a result of customer feedback.

Domino's use of social media as a marketing platform is designed to engage with members of the tech-savvy Generations Y and Z. However, this by no means excludes other age groups, and Domino's ensures there are still traditional options available for less technologically adept members of its consumer base.

10.2 Influences on marketing

Factors influencing consumer choice

Motivation

The key motivation for people ordering takeaway and home-delivery pizza is convenience. Hence, it is in Domino's interest to make the ordering process as streamlined and straightforward as possible. In September 2016 Domino's launched Zero Click ordering, which enables regular customers to open the Domino's app, and after a 10-second countdown it will place their favourite order, or one of their four most recent orders.

Domino's marketing also emphasises the range of options available, so consumers have choice along with convenience.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Psychological

Domino's is perceived to be an entry-level pizza store, although the advances it has made through technology are impressive. Consumers are aware when purchasing Domino's pizzas that they are buying a standard product that is fresh, tasty and always reliable. It is also very price competitive.

Its home delivery service adds to the convenience. Domino's position in the market lacks the ability to compete with dine-in stores. Domino's is perceived to be a delivery-based store.

Sociocultural

Domino's customer base covers all types of consumers, regardless of age, gender and culture.

In an attempt to cater to areas of Sydney with a large Islamic population, Domino's ran a trial of gaining halal certification for six stores. There was not a lot of consumer interest in this, so it was cut back to three stores – Auburn, Bankstown and Lakemba – but in 2015 these, too, dropped the halal certification.

Economic

Domino's is perceived to be a value-for-money business and as a result it has appeal across a range of income groups. During an economic downturn, it is likely that many people will still purchase pizza and this suggests that Domino's may become much more appealing to consumers than high-end takeaway stores.



Source 10.2 Domino's is perceived to be a value-for-money business.

Government

Local government licensing regulations require that all business involved in food preparation and service must have clean, hygienic premises and safe food-handling practices to prevent the spread of disease and food poisoning. The New South Wales Food Authority now has a register that names and shames offenders that have breached food standards and have resulted in public health issues. It is vital for Domino's licensees to comply with regulations, as a notice on one store can tarnish the consumer perception of the brand.

Recent concerns about obesity have led to calls for governments to take actions such as taxing unhealthy foods, banning junk food advertising and preventing fast-food outlets from operating in school areas. Although the Domino's range includes healthy alternatives, it would still be affected to some extent by any government activity in this area.

Consumer laws

The Australian Consumer Law requires businesses to honour implied terms of a transaction, in this case the delivery of a pizza.

Domino's policy is that if a customer is not completely satisfied, Domino's will replace or refund the order.

However, sometimes the system falls down. In October 2016, a New South Wales man was awarded $1200 by a court to compensate for an order he placed with Domino's in April 2015 that failed to deliver. The plaintiff stated that after a year of trying to get a resolution with respect to a refund, he decided to file a claim for breach of contract. Domino's did not appear in court, but advised a journalist that the man had been offered pizza vouchers at the time, but that was apparently not sufficient for him. Domino's paid the compensation, apologised to the customer and provided him with further pizzas and vouchers. The customer complaints process was also reviewed and changed.

Ethical

Products that may damage health

Domino's operates against a backdrop of obesity concerns about the takeaway and fast-food industry. To counter this, the calorie intake for each product is clearly labelled and obvious to the consumer. The business also offers a range of baked chicken and seafood pizzas.

In November 2016, consumer association Choice published a table comparing the kilojoule count of 149 fast-food pizzas from five different chains, including 26 Domino's pizzas. When ordered from lowest to highest kilojoule count, four Domino's pizzas were in the top 20 (a section dominated by now-defunct Eagle Boys), and the entire bottom half of the list contained only two Domino's offerings.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Engaging in fair competition

Like many takeaway food companies Domino's does engage in price wars with its competitors, but there have been no suggestions that this competition has been unfair. Nevertheless, pricing wars were one of the factors that led to the demise of Eagle Boys Pizza.

However, as noted, Domino's has now chosen to compete less on price and more by using innovation as a point of difference from its competitors. Customers are often willing to pay more for a perceived premium product, or for guaranteed faster delivery.

10.3 Marketing process

Situational analysis

SWOT

Source 10.3 shows a SWOT analysis for Domino's.

Product life cycle

In Australia, Domino's pizzas are in the maturity stage of the product life cycle. Consumers now have considerable choice as to where and how to purchase pizza. As a result, the Domino's marketing strategy needs to establish a competitive advantage by differentiating Domino's from its competitors. Domino's has a strategy of technological innovation and range expansion, while still maintaining its core pizza product.

Competitor analysis

Domino's holds 25 per cent of the takeaway and delivery pizza market in Australia – more than any other company in the market.

Pizza Hut is the largest pizza chain in the world and dominated in Australia through the 1990s. However, in the 2000s its growth slowed as Domino's and other competitors began to take market share. As at mid-2016, Pizza Hut had 10.7 per cent of the market. However, in November 2016 it acquired Eagle Boys Pizza, which may put it in a stronger position moving forward.

Crust Gourmet Pizza is a relatively small but significant player in the market – launching in 2001, it was the business that identified and capitalised on the gap in the gourmet pizza market. In 2012 both Crust and another business, Pizza Capers, were taken over by the Retail Food Group, which owns other food chains including Donut King and Michel's Patisserie. As at mid-2016, this group had 4 per cent of the pizza market.

Market research

Market research ensures that Domino's remains focused on offering customers an improved experience and stores with improved efficiencies.

It prides itself on being first to market when it comes to digital technology and innovation. In the 2016 financial year, the Australian Development Digital team delivered a record number of more than 80 digital projects and updates across the group. Having seen record online growth for each market, Domino's has pushed the boundaries of what can be achieved in this area.

Establishing market objectives

As with most businesses, Domino's three general marketing objectives are to increase market share, expand into new geographic markets and expand the product range.

Identifying target markets

Domino's uses a mass market approach. Its pricing and diverse range of pizzas means the appeal of the business extends to all types of consumers across age, gender and income.

Strengths	Weaknesses
• Reputation • Innovative • Ability to respond to changing consumer needs	• Perceived by consumers to be low-cost pizza
Opportunities	**Threats**
• Online delivery tracking • International expansion across Europe • New non-pizza menu items	• Obesity issues • New low-cost competitors

Source 10.3 SWOT analysis for Domino's

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

However, this approach does allow for the development of products specific to targeted groups within the larger market. The 'Melbourne range', for example, includes four new and improved pizzas, designed specifically for the people of Victoria. After completing extensive research of the Melbourne foodie culture, Domino's Global Development Chef Stefaan Codron and his team developed the range, which includes The Lot, Chicken Tandoori, Veggie Supreme and Capriciosa.

With seafood being a staple of Australian diets, the team also brought back the popular prawn pizza range, which is very popular in Australia's summer season.



Source 10.4 The prawn pizza range is very popular in Australia's summer season.

Developing marketing strategies

Domino's has embraced the global shift in power from corporations to the consumer by including social media as a key component of its marketing strategy. Domino's describes this trend as 'me-tailing'; that is, the fusion of social media and e-commerce. An example of this is the interactive Pizza Mogul platform, which lets people design their own pizzas, share them on social media and earn money for every pizza sold. Pizza Mogul integrates with social media platforms as well as Domino's existing online channels, and each week top-selling Moguls are ranked publicly and a variety of bonuses are awarded.

Pizza Mogul is recognised as a new way of marketing in which the user-generated content belongs to Domino's and thus can be shared freely to the wider market. Domino's CEO Don Meij says, 'This is, in my opinion, the future of retailing and I am so proud we have dreamt it and created it here at Domino's'.

Implementing, monitoring and controlling

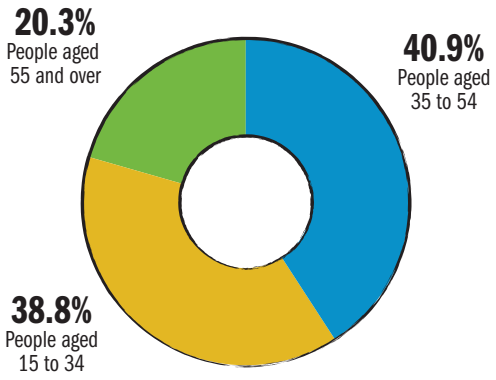
Domino's Australian marketing campaigns are implemented, monitored and controlled by the central marketing team.

Franchisees receive support in running their own local marketing, in addition to receiving the benefits of the larger, national campaigns.

10.4 Marketing strategies

Market segmentation

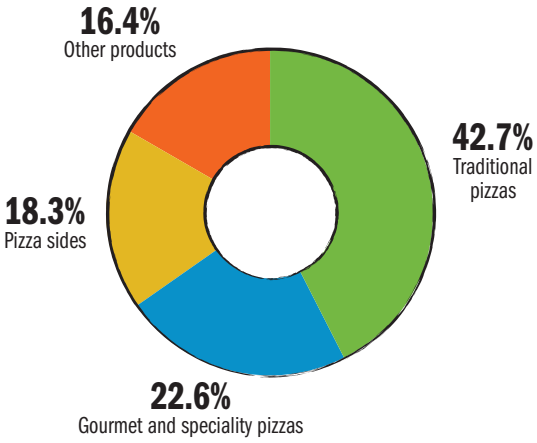
A 2016 IBISWorld report on Australian pizza restaurants and takeaway found that the major market segmentation is households, broken down by age group (see Source 10.5).



Source 10.5 Major market segmentation (2016–17). Source: IBISWorld.

Domino's aims to cover all segments of the market.

The report also suggests there are four key product segments: traditional pizzas, gourmet and speciality pizzas, pizza sides (e.g. chicken wings) and other products (e.g. drinks and desserts) (see Source 10.6).



Source 10.6 Products and services segmentation (2016–17). Source: IBISWorld.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Traditional pizzas once represented 90 per cent of the market, but in recent years the speciality segment has grown significantly. Domino's has been expanding its product range to take advantage of this greater interest in healthy eating and gourmet products, as well as offering a greater variety of pizza sides and other products such as desserts.

Product

Domino's is well recognised in the marketplace for its pizza products. However, it is important for the product line to continue to evolve and stay ahead of the market.

Goods and services

Domino's has moved beyond a set range of standard, low-cost pizza offerings.

Goods

The Chef's Best restaurant-quality range features a number of food product innovations, such as premium ingredients, quality packaging and unique post-bake sauces. The range includes the speciality six-slice rectangle-shaped base loaded with premium toppings including pulled beef, seasoned chicken, camembert cheese and fresh vegetables. The inspiration comes from street-food flavours across the world.



Source 10.7 A Chef's Best chicken and camembert pizza

In September 2016, Domino's announced 'Taste the Colour', its biggest menu launch since 2009. The emphasis was on fresh, tasty ingredients to move away from the homogenised flavours of some of its competitors. New pizzas included Lamb Tzatziki, BBQ Lamb and Bacon and Creamy Chicken Carbonara, and there were also new side dishes and desserts, such as Korean Spiced Sticky Wings, Mac n Cheese Croquettes, Caramel Fudge Pie, Cookie Brownie and Triple Choc.

Domino's is working towards creating a menu that is free of artificial preservatives, colours and flavours. This has been a major initiative and something it is aware cannot be achieved overnight – it will take commitment from the entire team as well as Domino's suppliers and business partners. A number of products are already artificial preservative, colour and flavour free, including chicken sides and all desserts.

Domino's also offers a gluten-free option, which allows sufferers of coeliac disease to enjoy pizza.

Services

The Domino's ordering system allows customers to design their own pizza from the range of toppings available.

The Pizza Mogul platform takes this further: the customer-designed pizza can be added to the Domino's list, and the designer earns money on every order.

In November 2016, following a survey of 6000 customers, Domino's launched a new gift idea, InstaGift, for the holiday season. These are digital gift cards that can be used for any purchase from the Domino's menu. Every stage of using an InstaGift is online, from purchase to redemption, so customers don't need to worry about losing a gift card they have received.

Branding

Domino's is easily identifiable through its red, sky blue and white logo. The logo has evolved through the company's history, but has always retained the same key features:

Source 10.8 The Domino's logo

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- the word 'Domino's'
- a domino tile containing two spots on one side, and one on the other. These three spots represent the original three stores.

Originally the logo also contained the word 'Pizza', but this was dropped when the company rebranded to emphasise that it offered 'more than just pizza'.

The logo is used outside and within the stores, as well as on staff uniforms and delivery vehicles. A consumer seeing a Domino's pizza being delivered in their neighbourhood may be prompted to place an order themselves.

Packaging

The key packaging feature for takeaway pizza is the box.

The industry-standard pizza box is made of flat-packed corrugated cardboard, which can be quickly folded into shape in-store, and with vents that allow moisture to escape, preventing the pizza from becoming soggy. In fact, it is commonly believed that these boxes were originally developed by Domino's in the 1960s. Certainly, Domino's in the United States began large-scale use of these boxes, which enabled stores to extend their delivery range. The pizza is cut into slices after being placed in the box.

When pizza is being home delivered, rather than collected from the store, the delivery staff use heat-insulating bags to carry the pizzas from the store to the customer. Again, this is an industry-standard approach, to ensure the pizza is as fresh as possible when the customer opens the box. Hot cell bag technology has allowed delivery drivers to deliver the pizza almost as hot as it was when it came out of the oven.

Domino's branding appears on both the box and the heat-insulating bag.



Source 10.9 Hot cell bag technology allows drivers to deliver pizzas almost as hot as when they came out of the oven.

Price

Pricing strategies

Domino's allows all types of consumers to enter the market. It offers a range of pizzas at different prices allowing for entry into the market at different points, with the standard pizzas being priced lower than the gourmet pizzas.

Its products and pricing reflect the interests of its customer base. Pizzas are diverse and encompass many flavours. Standard pizzas start at $13.90 and have wide appeal to all types of consumers. Domino's has recognised that consumers are seeking healthier choices and now offers chicken and seafood pizzas starting at $16.90.

Price and quality interaction

Domino's pricing is similar to that of its competitors. However, the business lacks the prestige of dine-in Italian/pizza restaurants, and the ability to offer promotional pizzas at $4.95 may create the impression that the quality of inputs is lacking.

On the other hand, the price differentiation between standard and gourmet pizzas suggests to consumers that some pizzas are of higher quality than others.

Promotion

Advertising

Advertising is a key part of the marketing mix for Domino's. Advertisements focus on three key areas:

1. pricing and value for money
2. quick delivery and the freshness of the product
3. the new range of products the business is selling.

Advertisements normally feature from 5 p.m. onwards, suggesting the idea of having pizza for dinner.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Sales promotions

Domino's offers customers package prices that may include breads, drinks and desserts. This emphasises the concept of value for money and reinforces the appeal that the business has across all income groups. Domino's is also featured on sales vouchers from supermarket receipts offering discount pizzas.

The communication process

To widen the communication net, and encourage people to talk about its products, Domino's has a presence on a wide range of social network sites:

- Facebook
- Twitter
- Google+
- YouTube
- Snapchat
- Instagram.

Place/distribution

Domino's makes use of intensive distribution. Online and phone ordering make the product easily accessible, and then the business does the rest. The product is available across all parts of Australia. This has the benefit of making the product accessible to all types of customers.

Distribution channels

Domino's uses a 'producer to consumer' distribution channel. Pizzas are made and cooked in-store: every store contains the essential pizza-making equipment, with the raw materials, such as the pre-packed dough mix, obtained from a central supplier.

The finished pizza is collected by the customer, or delivered directly to them by the store's delivery staff.

Physical distribution issues – transport, warehousing, inventory

The key distribution issue with takeaway pizza is ensuring it is still hot and fresh when the customer opens the box. The longer a pizza sits on a rack waiting for collection, or in a delivery vehicle, the more it deteriorates and quality is compromised.

This is partly addressed by the packaging – the pizza box, pizza saver and, if the pizza is being delivered, the heat-insulating bag, all extend the time a pizza can wait.

But Domino's has made further innovations. For example, in June 2016 it announced its On Time Cooking feature, which uses geo-location technology to ensure pick-up customers always receive fresher, hotter pizzas straight from the oven. Customers using this service let the mobile app know how they are getting to the store (car, bike, foot) and this will help define the 'Cook Zone' – a virtual area around the store. The app will notify the store when the customer has entered the Cook Zone and the store will start cooking the pizza once they receive this notification.

Whenever technology enables an improvement to the customer experience, the marketing team make sure the message is broadcast.

People

Many of the people working in Domino's stores are customer-facing, so good customer relations are an important part of job descriptions.

Processes

Ordering

Because pizzas are made and delivered by individual franchisees, customers can go to the store to make an order, or phone it directly.

However, Domino's also has a centralised ordering system, which relays orders to the relevant store.

Originally this was only available by phone: Domino's paid for the branded toll-free number 1300 DOMINO (1300 366 466). However, as technology progressed, Domino's added new options:

- online ordering via its website
- SMS ordering, including an option for customers to place their last order or their 'Fast Favourite' in just a few seconds, by texting the word 'pizza' or sending the pizza emoji
- the Domino's app, with its latest enhancement, Zero Click Ordering, which allows the customer to order a pizza without even touching a button.

Payment

Domino's is also planning to streamline the payment process in 2017, by enabling Apple Pay and Android Pay.

Delivery



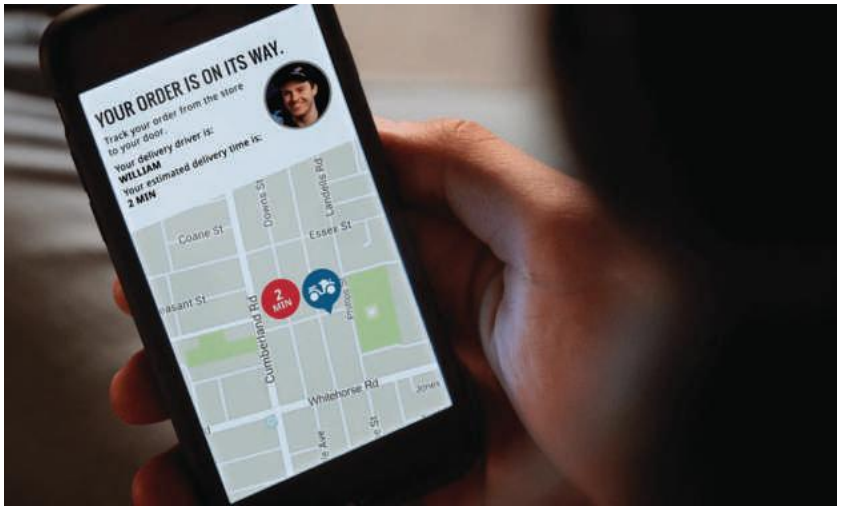
To offer better service to customers, Domino's is continually enhancing the delivery process.

A key focus of the company's 'Slow Where It Matters, Fast Where It Counts' philosophy is the introduction of Project 3/10 – a goal of having a pick-up order complete in three minutes and a delivery made in under 10 minutes. This project was inspired by new ovens that reduced the pizza cooking time

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

from seven to four minutes. The aim now is to reduce it to three minutes.

The GPS Driver Tracker was originally brought in as a driver safety initiative, but it has also meant that Domino's can use new technology and algorithms to offer customers faster and safer deliveries. This led to the introduction of 15 and 20 Minute Service Guarantees, where customers can pay a small fee to ensure their pizza is delivered in 15 or 20 minutes.



Source 10.10 The Driver Tracker lets customers see when their pizza will arrive.

In 2016, Domino's also moved into automated deliveries. The Domino's Robotic Unit (DRU) is a four-wheel autonomous vehicle that can travel from the store to the customer's home at a safe speed along the footpath. Later in 2016, Domino's also made the world's first pizza delivery by drone.

Physical evidence

As noted earlier, the key packaging feature for takeaway pizza is the box. However, other aspects of physical evidence include the delivery vehicles, and the presentation of the person who makes the delivery.

E-marketing

Domino's relies on e-marketing to sell its products. Consumers are now able to order a pizza online and follow its progress before it reaches the door. The website offers consumers detailed information on product choice, price and health considerations. The website and the app have become stores that are portable and can be accessed anywhere a consumer has access to the internet.

Global marketing

Domino's is a global brand, and is growing in most of its markets. For example, in the 2015–16 financial year, the European market added a record number of 366 new stores, while there were 69 new stores in Japan.

Global branding

All Domino's stores are branded with the same logo. This provides the benefit of trust and familiarity in an age where people are travelling much more.

However, advertising does need to fit with the cultures of different countries. There have been occasions when the global team has removed commercial campaigns from the airwaves within 24 hours of appearance.

Standardisation and customisation

Domino's maintains a balance between global consistency and local adaption. For example, in Europe Domino's offers potato toppings, while in Asian markets the toppings include seaweed.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Multiple-choice questions

1 Which two factors contributed to the growth of profitability of Domino's?

A Increased product range and lower prices
B Increased number of stores and the decline of competitors
C Increased number of employees and improved cost performance
D Increased funds allocated to marketing and greater consumer awareness

2 Which of the following influences on marketing is most likely to benefit Domino's?

A Economic influences through reduced consumer spending and higher unemployment
B Socio-cultural influences through a reduction in the number of stores catering to the needs of local consumers
C Psychological influences through increased costs associated with online ordering and delivery tracking
D Legal influences through a reduction in the number of hours casual employees are able to work

3 Which of the following represents Domino's target market?

A Niche market with emphasis on food products catering to specific customer needs
B Market segment allowing the business to focus its products and marketing towards families
C Mass market where pricing and diverse range of pizzas means the appeal of the business extends to all types of consumers across age, gender and income
D Industrial market to ensure all product ingredients are accessed from local suppliers

4 Which of the following is a perceived threat for the future of Domino's?

A The reputation of the business as an innovative quick service food provider
B International expansion across Europe
C A perception by some customers that the business is low cost – limited quality
D The rising awareness of obesity and greater government attempts to discourage unhealthy eating

5 Which global marketing strategy allows Domino's to capture increased market share of specific markets?

A Global branding
B Standardisation
C Customisation
D Marketing

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Short-answer questions

1 Outline how Domino's uses promotion to market its business.

2 Complete a SWOT analysis on Domino's.

Extended-response question

With reference to Domino's, assess the effectiveness of the marketing strategies used by Domino's in achieving its strategic goals.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Topic 3

Finance

25% of indicative time

Principal focus

This topic focuses on the manner in which business planning and management relies on the interpretation of financial data.

Introduction

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- 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 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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- and long-term financial objectives may conflict
- 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

11 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

11.1 Introduction

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.



Source 11.1 Financial management deals with the analysis, interpretation and evaluation of all financial records of the business.

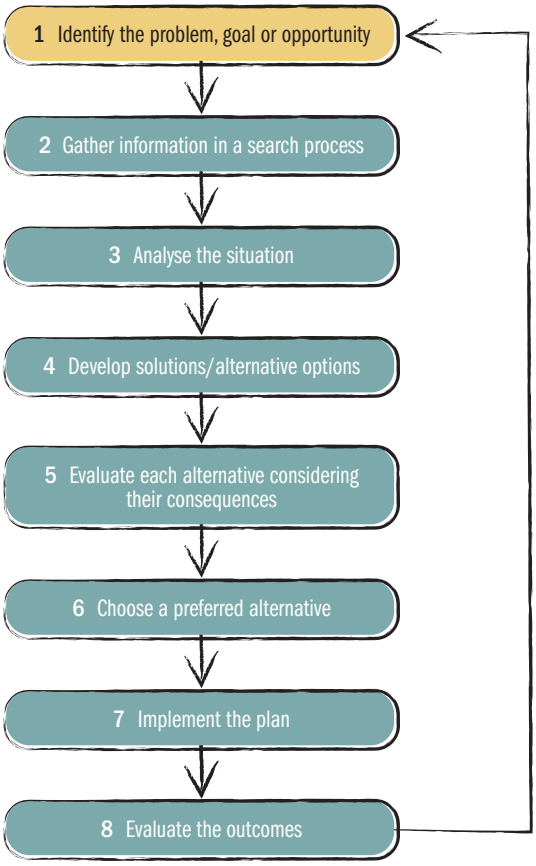
11.2 Strategic role of financial management

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 to 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 it is able to cover its costs by paying bills as they fall due and ultimately to make a profit. In Australia, for the year to March 2016, the Australian Securities and Investments Commission (ASIC) recorded 4104 business-related **bankruptcies**. Other data indicate that very few businesses survive until the retirement of the owner.

Source 11.2 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.



Source 11.2 The decision-making process used by owners and managers

11.3 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 – and 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.

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.

Profit What remains from revenue after all expenses have been paid.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

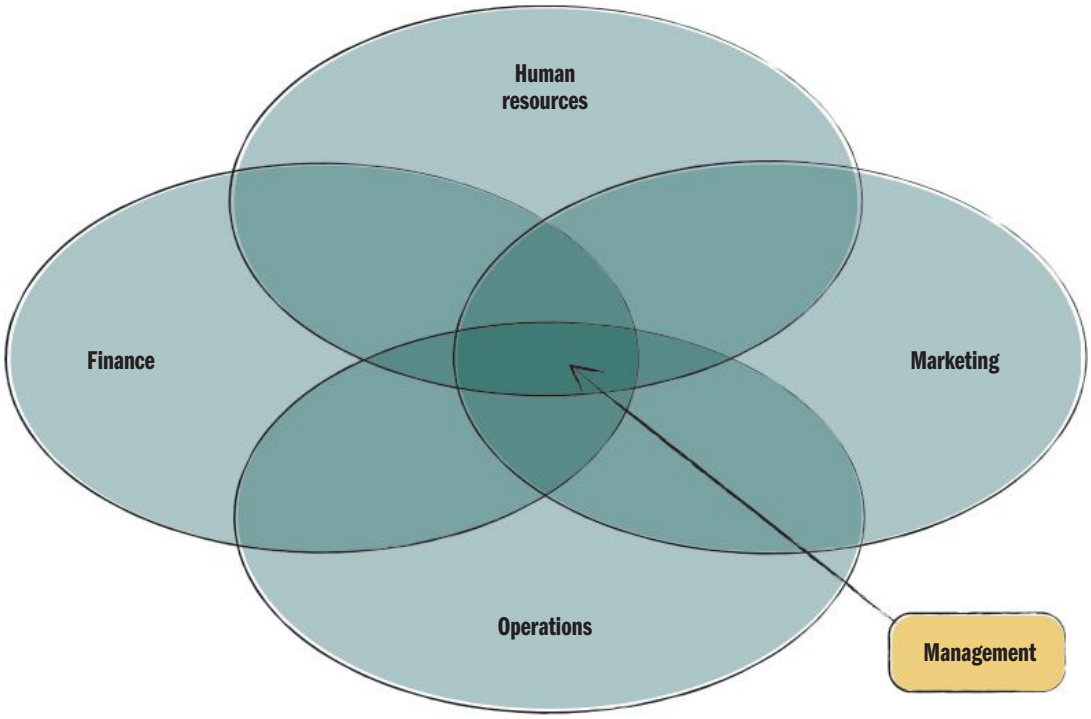
Dividend The income earned from owning shares in a company. It is usually paid every six months and is based on the profits the company makes.

The owners can choose to reinvest it back into the business to help it grow and expand (this is known as retained profits as the owner is choosing to retain part of the profit back into 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).

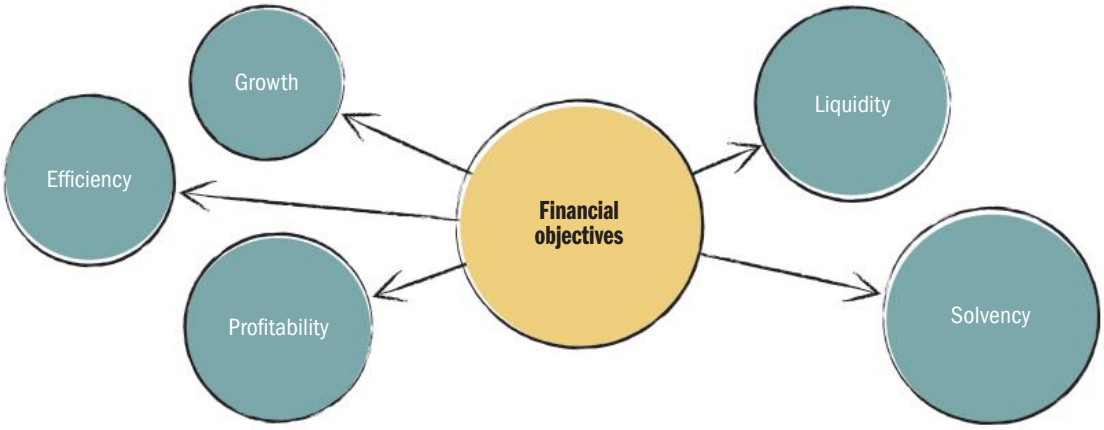
The role of financial management is to develop a tactical plan identifying short-term financial objectives and strategies that enable finance to support the whole business in achieving its strategic goals (see Sources 11.3 and 11.4). The financial manager's objectives will include the business's profitability, growth, efficiency, liquidity and solvency (see Sources 11.4 and 11.5). Their job will be to make short- and long-term funding decisions on debt and equity sources of funds, to develop financial policies such as cash control or borrowing and making the best use of the organisation's scarce financial resources.

Ethical spotlight 11.1

Some objectives may conflict. For example, imagine you are the financial manager of a pharmaceutical company considering the amount of finance to provide for the trial of new drugs. How do you balance the financial needs of the company as a whole, with the fact that seriously ill people need the medicine to be available as soon as possible?



Source 11.3 Finance must support each of the other business functions.



Source 11.4 Financial objectives

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Source 11.5 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) **Net profit** (income statement) Earnings before interest and tax (EBIT) (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, then it has made a loss.
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 Number of outlets	Compare business sales to total market sales. The higher the percentage, the larger is their market share.
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- 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- and long-term debts as they fall due, it is solvent. It needs to be able to make its repayments for debt finance.

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.

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.

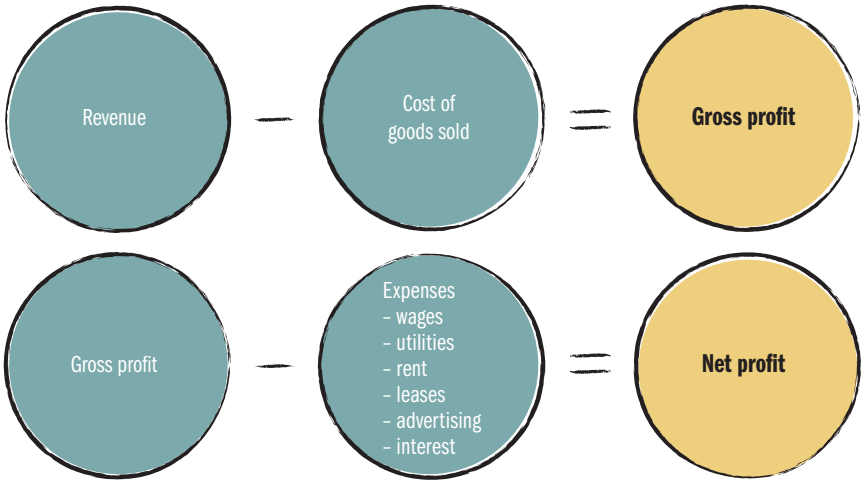
Gross profit is the profit made on the sale of goods after paying the cost of purchasing them from the wholesaler and transporting them to the business ready for sale; that is, sales revenue minus cost of goods sold. Alternatively, it is the cost of buying the inputs that are transformed into goods for sale. The gross profit figure does not take into account any other expense, and is sometimes referred to as mark-up.

Net profit is the final amount of revenue remaining after all expenses have been paid. Source 11.6 shows how net profit is determined.

Profitability is measured using net profit. A financial manager is able to work out whether the

Profitability The earnings of the business after expenses have been paid.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 11.6 Calculating net profit

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.

Growth The size of the business compared to its competitors in the same market.

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 profitability in the long term. Increased output will 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 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

In 2009, a two-person start-up business launched a fitness product: the Fitbit Tracker. This was a small device that sensed movement, and could be clipped to a pocket. When plugged into a computer, it uploaded its information to the Fitbit website and gave the user information about the distance they had walked, calories burned, activity intensity and sleep patterns. The business grew by expanding and improving its range of products. As well as adding extra levels of tracking (e.g. heart-rate monitoring), it kept abreast of other changes in technology and the increasing public interest in fitness wearables. Some of its key products were:

- **Fitbit One (2012), which used Bluetooth to connect with a smartphone app**
- **Fitbit Flex (2013), which was the first Fitbit to be worn on the wrist**
- **Fitbit Surge (2014), which could receive alerts for calls and texts from a connected smartphone**
- **Fitbit Blaze (2016), with similar capabilities to modern smartwatches (e.g. the Apple Watch).**

In 2015 the company listed on the New York Stock Exchange, and was valued at over $4 billion. However, its value dropped in 2016, perhaps due to the fitness wearables market becoming congested, and the company has since announced that it will be expanding its focus to cover a broader 'digital healthcare' spectrum.



Source 11.7 The Flex was the first Fitbit to be worn on the wrist.

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 7 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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 11.1 Simple income statement

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

1 Calculate the revenue that this business achieved.

2 Calculate how much Elfie has paid for the inventory she actually sold.

3 Deduce whether Elfie owns the premises and explain how you came to this conclusion.

4 Calculate the profitability of this business. (Hint: see Source 11.6)

5 Calculate the efficiency of this business. (Hint: [expenses ÷ sales] × 100)

6 Discuss the profitability and efficiency of this business.

Activity 11.2 Comprehension

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 growth could be measured.

4 Explain why objectives of growth and profitability may cause conflict in the short term.

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.

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.

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 which have been paid in advance.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 11.8 and 11.9 illustrate the breakdown of different current assets, which is an important factor when determining liquidity.

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 11.8 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

Source 11.9 Balance sheet for Business B

Current assets	$	Current liabilities	$
Cash	4 000	Bank overdraft	2 000
Inventory	3 000	Accounts payable	3 000
Accounts receivable	3 000		
Total current assets	10 000	Total current liabilities	5 000

Business A has twice as much finance available needed 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.

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.

Creditors The businesses, financial institutions and individuals to which a business owes money. Also known as accounts payable.

However, a business with very high liquidity is not 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.

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 11.10 Having too much cash saved is a waste of financial resources and a loss of potential profits.

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, their 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- 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 11.3 Comprehension and application

1 Explain how return on capital can be used as a measure of profitability.

2 Imagine you are the senior financial manager of The Big Boys Clothing Company, a large retailer of street fashion clothing for 16- to 28-year-olds. 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: The Big Boys Clothing Company's strategic goal is to achieve a net profit ratio greater than 15 per cent for the next financial year. Financial objectives could include: to eliminate bad debts and impose stricter controls on accounts receivable customers to less than 40 days and achieve a turnover rate of nine times per year. Another objective could be to introduce new technology to cut costs.

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**.

A business may wish to source the cheapest funds available for the finance necessary to pursue its goals; however, these 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, then 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 and long term. Consumers can reward businesses that use socially responsible methods of production by purchasing the products of that business.

Short term In less than a 12-month period.

Long term Longer than a 12-month period.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 11.11 A business can reduce its environmental impact by encouraging employees to recycle.

11.4 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 their product successfully. The financial manager will also need to develop budgets and cost controls for operations, encouraging them 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

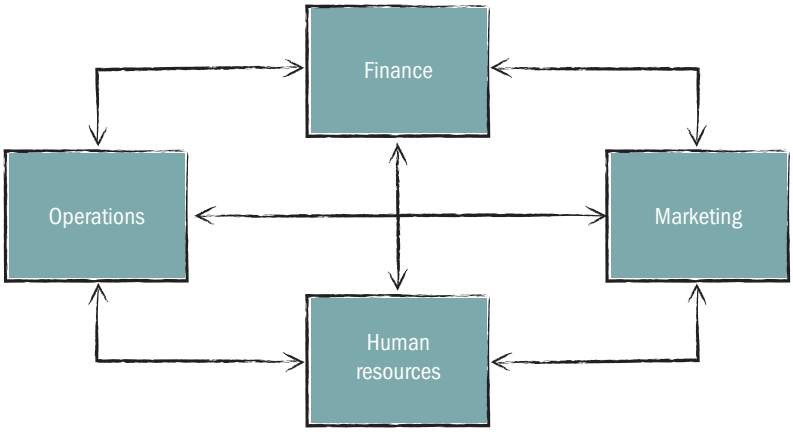
A business has only a set amount of funding. If marketing is provided with large amounts of funding, so that operations – which provides the core product – does not have enough money to keep up supply, then the money spent on marketing will be wasted. Finance needs to determine the best allocation of 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 11.12 Interdependence of business functions



Source 11.13 A successful marketing strategy can lead to increased sales and profitability.

Business Bite

Dick Smith created Dick Smith Foods, as a private and independent company, to support Australian farmers and businesses. Its products are made in Australia, by Australian-owned companies. This means that Australians are employed and that the profits remain in Australia, helping our future. The company deals with businesses that operate in a highly ethical manner. The ultimate goal of Dick Smith Foods is to give away all of its profits to charity. From the commencement of Dick Smith Foods to mid-2016, donations have totalled more than $7.9 million to over 400 charitable organisations in Australia. However, at times some profits need to be reinvested back into the business to enable it to grow and remain competitive. Some of Dick Smith's royalty arrangements now have a specified marketing percentage that allows for reinvestment into price promotion with all profits continuing to be given to charity.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 their 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

Rewrite the following passage on the planning cycle, using the words listed in the box below to fill in the blanks.

stability	rely	human resources	return	short-term
strategic	funds	inputs	market share	gearing
profit	finance	liquidity	net profit	owners

It is a financial manager's responsibility to source _____ to enable a business to achieve its _____ goals. A prime objective of many businesses _____ is to become wealthy. Any _____ the business makes belongs to the owners. A business pays tax on its _____ for each financial year. Financial reports are prepared to give a detailed financial picture of the business's profitability and financial _____. Objectives of a business may include:

- Growth: growth can be achieved through the takeover of another business or by increasing its _____
- Profitability: providing a _____ on the owner's initial investment
- Efficiency: by achieving increased output from the same level of _____
- _____: by being able to pay all of its short-term debts as they fall due
- Solvency: by decreasing its _____ levels

It must be remembered that _____ objectives need to be achieved to gain long-term objectives.

The key business functions of _____, operations, marketing and _____ are interdependent and _____ on each other for success.

Multiple-choice questions

1 Which objective of financial management is concerned with the ability of a business to efficiently manage its revenue and expenses?

A Profitability
B Liquidity
C Efficiency
D Growth

2 What is liquidity used to determine?

A The profitability of a business
B The ability of a business to repay its short-term debts
C The cost of goods sold
D The ability of a business to maximise revenue

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

4 During the growth stage of the business life cycle, what is the most likely short-term financial objective of a business?

A Profitability
B Efficiency
C Liquidity
D Return on investment

5 Which of the following can be used to measure business growth?

A Sales, market share and net profit
B Expenses, cost of goods sold and sales
C Profitability, liquidity and market share
D Expenses, equity and net profit

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 The level of gross profit is determined by:

A Total revenue minus all expenses
B Total revenue minus cost of goods sold and freight inwards
C Cost of goods sold minus expenses
D Total revenue minus net profit

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- 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- and long-term liabilities as they fall due

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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- 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

12 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
- interest rate
- 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

12.1 Introduction

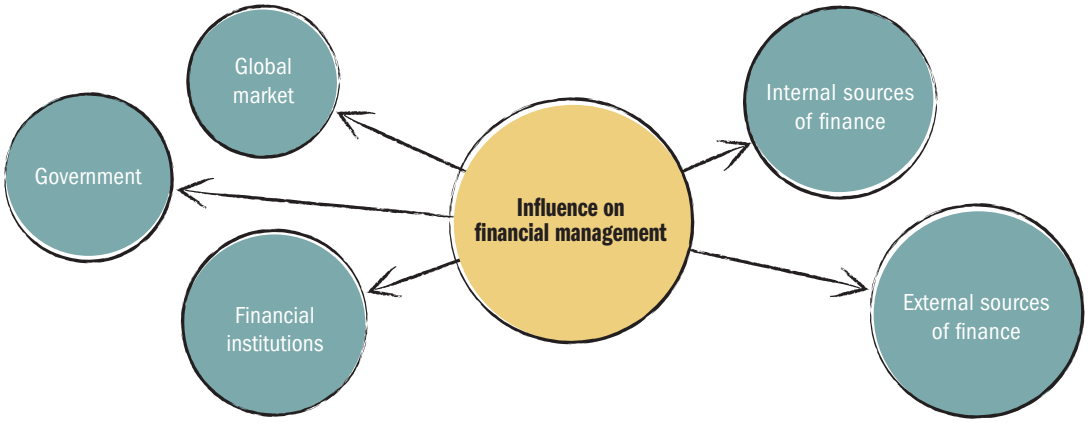
Financial management involves planning, organising, monitoring and controlling the monetary resources of a business in a way that will fulfil its financial objectives and enable the business to achieve its strategic goals. It involves the efficient and effective management of the business's funds achieved 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 12.1.

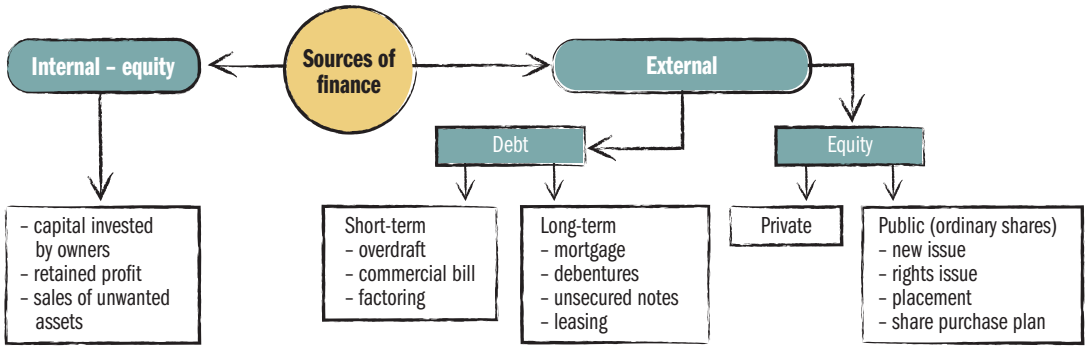
People who wish to set up their own business will need to obtain funding to make their idea a reality. When the business is in operation, additional funding may be required for the development of new products, global expansion or even mergers and takeovers. Whatever the reason for the need of additional 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.



Source 12.1 Influences on financial management



Source 12.2 Sources of finance

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

12.2 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 his or her 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.

Debt finance Any type of loan that a business obtains that is issued by a promise of repayment on a certain date at a specific rate of interest.



Source 12.3 An owner may decide to reinvest profits back into the 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.

Activity 12.1 Comprehension

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.

12.3 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

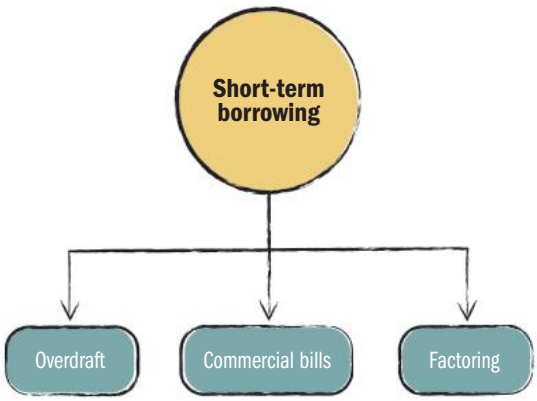
Debt finance is any money that has been borrowed. These borrowed funds will need to be repaid within a specified period and incur interest charges and administration fees. The costs of this type of finance are a tax deduction for the business. Debt finance is generally categorised according to the term of the loan; that is, its repayment period. Generally, a short-

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

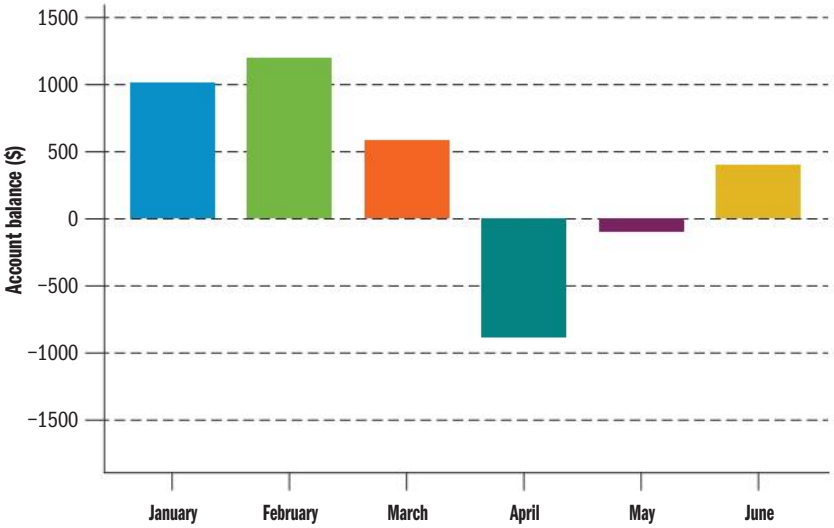


Source 12.4 Short-term borrowing

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.

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.



Source 12.5 An overdraft facility allows a business to have a negative value in its account.

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.

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.

Activity 12.2 Comprehension

1 Describe two advantages for a business having an overdraft facility with its bank.

2 How could an overdraft become a problem for the business?

Ethical spotlight 12.1

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?

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Commercial bill An agreement to repay the short-term loan plus interest to the lender on a specific date.

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.



Source 12.6 A commercial bill 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 Occurs when a business sells its accounts receivable asset to a specialist factoring firm to create cash inflow for the business.

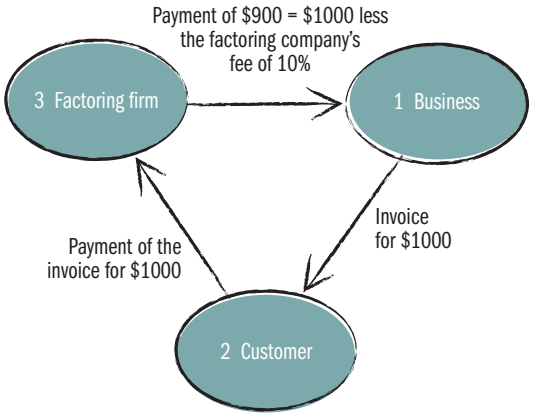
Trade credit Money owed to a creditor for the purchase of supplies and services that have already been provided.

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 12.7 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.

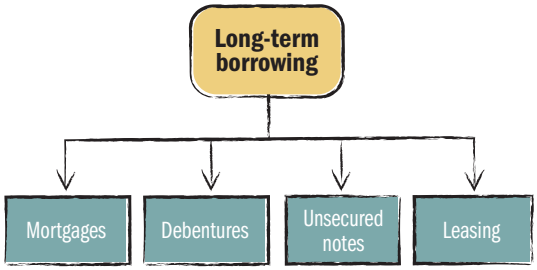
Ethical spotlight 12.2

Some businesses operate on a cash-only basis. What advantages and disadvantages would there be for the business owner? Do you think many businesses do this? Could some businesses be trying to avoid paying taxes? If so, are they being socially responsible?

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 12.8 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

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 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

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.

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.**

Centre Court debentures were marketed in the early summer of 2014. 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. The money raised is used to fund the continued development of the grounds and facilities.

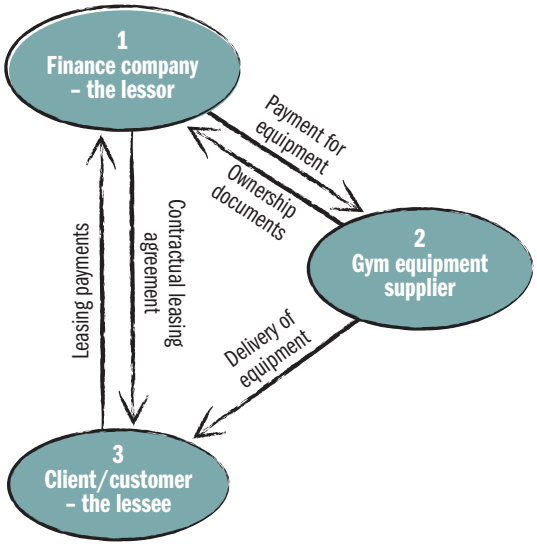
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Leasing

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.

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 time with an ongoing, regular payment that allows it to use an asset that is owned by another business. The firm has a contractual obligation to pay another business and therefore 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.



Source 12.10 Leasing arrangement for gym equipment. On the last payment of the lease or residual price paid, the ownership is transferred to the lessee.

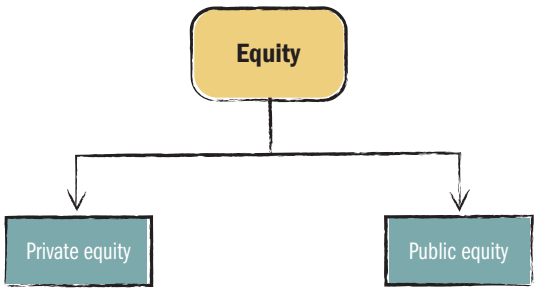


Source 12.9 A fitness centre may decide to lease gym equipment rather than purchasing it.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 12.11 Equity

Private equity

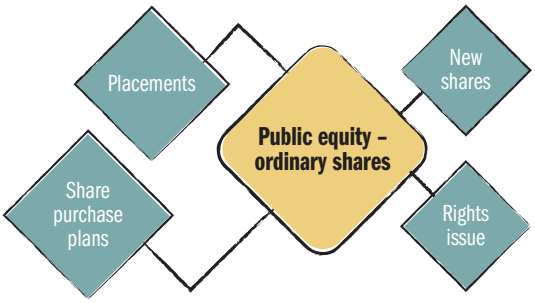
If a business is incorporated as a private company and does not wish to increase its level of debt, it can invite specific people to become part-owners by selling them shares in the business. The owners have gone outside the business to seek external equity finance. The advantage for the business is 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. Using our restaurant example, let's assume that your business sells nine shares at $10 000 each to nine friends. These shareholders will give you $90 000. To this you add $10 000, which is your share of the business, giving you the total finance ($100 000) needed to open the restaurant. 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 12.12 Public equity – ordinary shares

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.

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 100 000 shares are offered at $1 par 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.

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.



Source 12.13 Shares are made available on the ASX (Australian Securities Exchange).

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Rights issues

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.

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, 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.

Business Bite

Kogan.com is a website that specialises in selling technology such as phones, TVs, computers and cameras. Kogan.com was listed on the ASX on 7 July 2016 through a prospectus that was available to the public. Its intention was to raise capital of $50 million. The issuing value of the shares was $1.80. Canaccord Genuity (Australia) Limited underwrote the offer, which expired on 29 June 2016.

Placements

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.

Share purchase plan Companies can offer up to $15 000 in new shares to each existing shareholder at a discounted price.

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.

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.

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 a below-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.

Activity 12.3 External equity

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		

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

In October 2015, Macquarie Group Limited announced that it would be acquiring Esanda Dealer Finance from the ANZ Banking Group Ltd. In order to finance this, the Macquarie Group needed to raise money; $400 million was to come from a placement offering shares to institutional and professional investors. In addition, a share purchase plan gave eligible Macquarie shareholders the opportunity to purchase up to $10 000 of ordinary shares, free of brokerage and transaction costs.

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 government low-interest 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. They are often available to businesses with export potential.

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.

Activity 12.4 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 12.5 Comprehension

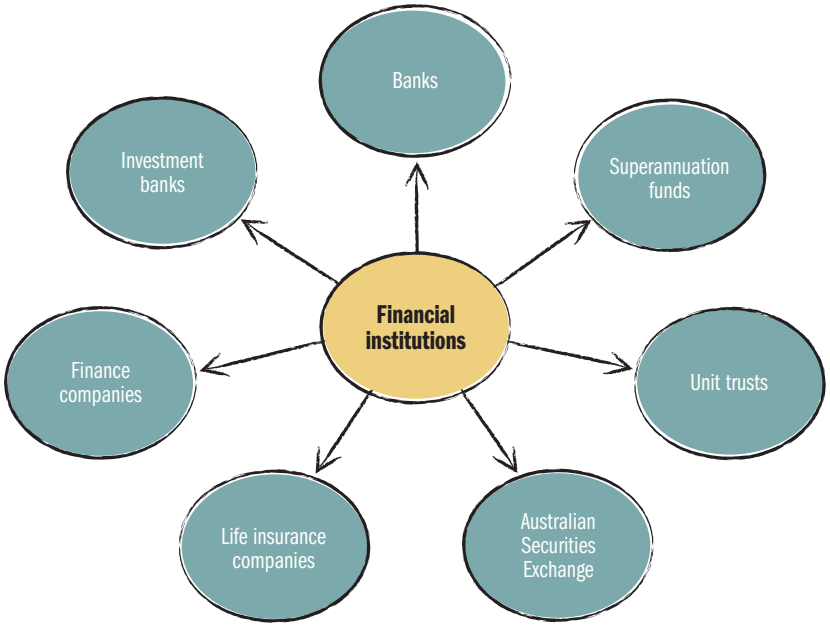
1. Explain why an owner of a private company might be reluctant to acquire additional equity finance from shareholders.
2. Describe the difference between a private company and a public company.
3. Explain the factors an owner would need to consider before sourcing additional finance.
4. Identify the 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

12.4 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 for their needs with the best terms.



Source 12.14 Financial institutions

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.

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 Competition and Consumer Commission (ACCC) – deals with competition policy.**

Along with the Australian Government Treasury, these agencies form the Council of Financial Regulators. The council provides advice to the government on the current Australian financial regulations.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Banks

Banks accept deposits from the general public and provide funds for loans. Most large banks have specialist business services that are separate from 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 Esanda and GE Finance, 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/consumer fails to repay a secured loan, the asset will be forfeited to the lending institution.

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

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.

BPAY Payment of bills using online (internet) banking.

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.

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.

Source 12.15 HSBC is an investment bank.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 policy holder'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 aged between 18 and 69 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. It is estimated that by 2016 there will be approximately $2 trillion in superannuation funds. 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.

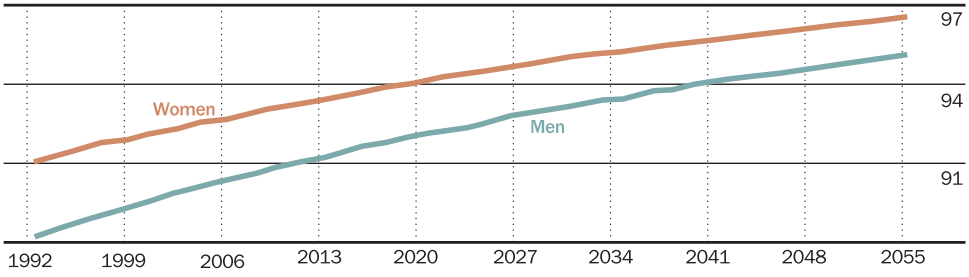
Superannuation fund
All superannuation payments are invested in a superannuation fund. The fund invests the superannuation in, for example, shares or property to earn a return for the employees whose superannuation has been invested with the fund.

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. 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. Some examples include MG Unit Trust, set up by Murray Goulburn Co-operative Co. Ltd in 2015, and the MLC MasterKey Unit Trust, which has been operating for more than 25 years.

Historical and forecast life expectancy (years)



Quick super facts

- **$2trn** in assets
- **$9trn** by 2040
- **15%** of Australians are retirement age
- **21%** will be in 2040
- Average super balances for 55–64 year olds:
- Men **$322 000**
- Women **$180 000**
- **25%** of the population has no super
- A retiree in 2015 will live, on average, 50% longer than someone who retired in 1947.

Source 12.16 Superannuation: funding for future retirement and present-day business growth. Source: Committee for Sustainable Retirement Incomes, Treasury, ABS.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 12.6 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 on financial markets as a provider of finance.
6. Is AMP a bank? Recall the criteria for becoming a bank and use them to support your answer.

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).

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 exchange 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; CHESS (Clearing House Electronic Subregister System) 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 the Australian Securities and Investments Commission (ASIC). The issue of shares for the first time is referred to as an Initial Public Offering, or 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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 12.7
Comprehension and research

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.

4 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.

12.5 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 is through ASIC and company taxation.

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, 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



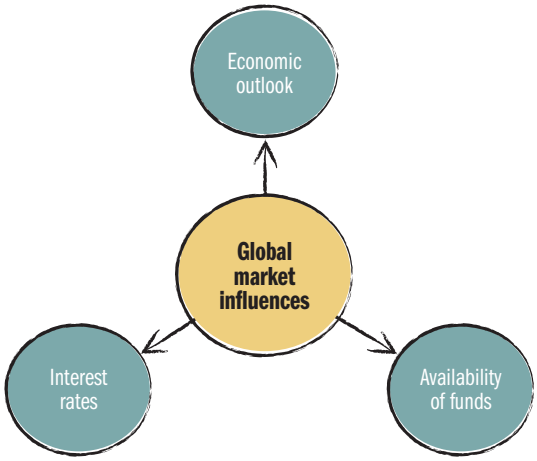
For 2017, company tax is currently a flat rate of 27.5 per cent on net profit for small businesses; that is, those with less than $10 million turnover in the financial year. Larger businesses (that is, those with more than $10 million turnover) are subject to 30 per cent tax. This has gradually decreased 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 Japan (32 per cent) and the United Arab Emirates (55 per cent). Other countries have lower rates, such as the United Kingdom (20 per cent), Thailand (20 per cent) and Taiwan (17 per cent), and 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.

12.6 Global market influences

Overseas influences have increasingly affected the Australian financial market due to globalisation and increased interdependence between economies and foreign markets.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 12.17 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. It has taken at least five years for many economies to achieve positive growth after the Global Financial Crisis (GFC) of 2008–09.

In 2016, global indicators show continued slow growth in advanced economies. Several factors have influenced this, such as:

- lower energy, metals and other commodity prices worldwide
- the slowdown of the Chinese economy, rebalancing away from investment and manufacturing and towards consumption and services
- the slowdown of other emerging economies such as India
- political shocks and uncertainty, such as in Brazil and the United Kingdom's 2016 referendum (Brexit) to withdraw from the European Union (EU)
- the slow and steady recovery of the US economy along with its increased monetary controls.

All of these factors mean lower prospects for global trade between nations. Currently, global growth is estimated to remain positive, at about 2 per cent. Other influences may also result in increased uncertainty for financial negotiations, especially as the United Kingdom realigns itself away from the EU. This could, however, open up new opportunities for trade with other nations such as Australia.

A downturn in the global economy or a downturn in the economies of major trading partners may cause the Australian economy to weaken, as demand for



Source 12.18 The United Kingdom leaving the EU has created unease in the global market.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Australian products decreases. There will also be influences on the financial market caused by the value of the Australian dollar against currencies of other countries. As the dollar increases in strength, the prices of Australia's exports increase and become less competitive.

Businesses make financial decisions based on their expectations for the future. Increased demand for their products encourages growth and the need for increased funding for a business. A better economic outlook encourages risk-taking.

Interest rates

As part of managing proactively, financial managers will be concerned about changes in the future cost of finance; that is, the rate of interest charged. There will also be different **interest rates** between countries. As interest rates are often lower in overseas markets, businesses like to raise finance overseas. However, adverse currency movements may eliminate the advantages of lower interest rates. The GFC and subsequent uncertainty in the market caused overseas interest rates to increase substantially, adding to the cost of finance and possibly making previously viable projects far less profitable.

Interest rate The rate of interest charged per year as a proportion of the amount borrowed.

Availability of funds

If Australia is seen as providing a higher return than Japan or the United States, 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. Fund availability and risk are reflected in the interest rate charged. The larger the risk, the higher the rate charged.

International shocks such as the Asian financial crisis (1997–98), terrorism, the 2004 oil shortage, the swine flu epidemic in 2009, the GFC, the major earthquake and tsunami in Japan in 2011, Typhoon Haiyan in the Philippines in 2013, as well as ongoing debt crises in Greece, Italy and Ireland and the Brexit vote have also affected Australian businesses to some degree by creating greater uncertainty in the market.



Source 12.19 There will be different interest rates between countries.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- 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.

Globalisation has resulted in finance flowing into Australia when interest rates are higher than 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision tasks

1 Select terms from the list provided that best complete the following sentences.

capital	owner	float	primary
securities	secondary	shares	additional
investor	ASIC	prospectus	public

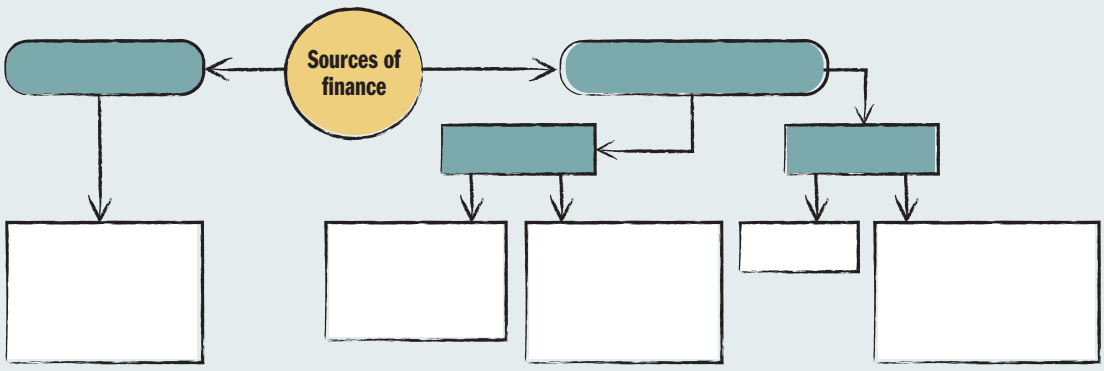
A business wishing to _____ on the Australian _____ Exchange must submit its prospectus to the ASX and _____. Having satisfied the conditions of these regulators, the issuing company offers a fixed number of _____ at a stated price to the general _____. The _____ provides a potential _____ with company 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.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 An entrepreneur who provides capital to a high-risk business venture in exchange for part-ownership:

A provides leasing finance
B expects an immediate return on investment
C provides bridging finance
D is a venture capitalist.

3 When interest rates are expected to fall, what is a financial manager's most likely response to additional funding needs?

A Reduce the level of equity in the business
B Increase the level of debt in the business
C Encourage credit sales to increase cash inflow
D Reduce output to reduce costs

4 Unincorporated businesses are:

A limited to using only debt as a source of finance
B limited to using only equity as a source of finance
C able to sell shares
D unable to sell shares.

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 Which organisation/s oversee financial intermediaries?

A Government departments
B Venture capitalists
C APRA
D RBA

8 The cost of factoring for a business is:

A an increase in accounts payable
B increased interest charges
C part of its ownership
D the commission charged by the factoring company.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 cheque/current account facility
B part of their equity financing
C provided through their insurance company
D a long-term solution to their problem.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

13 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

13.1 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.



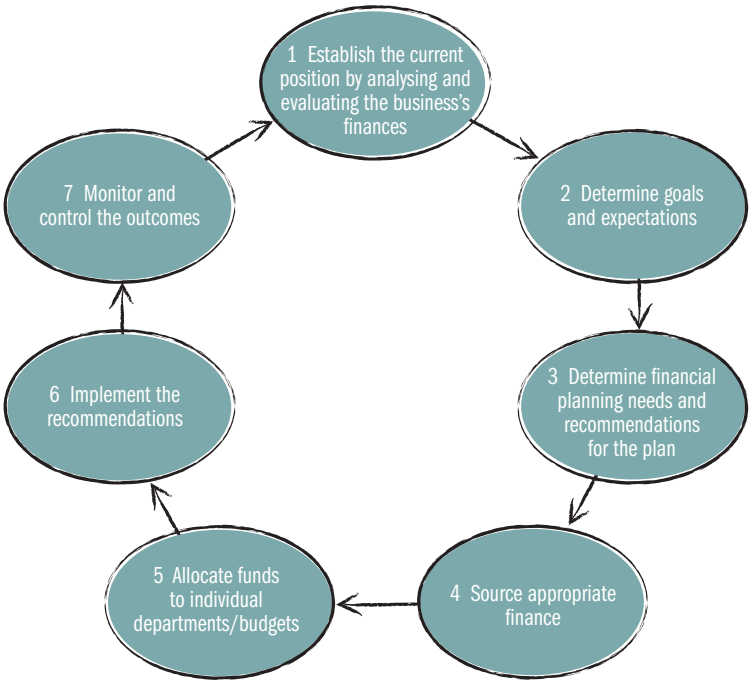
Source 13.1 Planning and implementing financial management

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.

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 13.2 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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 13.3 Businesses can use past performance records to predict future budgeting needs.

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.

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.

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.

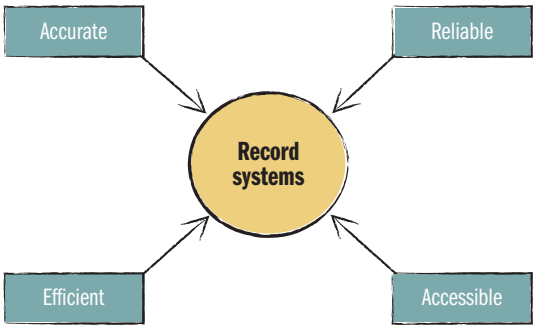
Accounting records of expenses and revenues must be kept by law and a company's annual financial

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 resources department would need to have access to employees' work history, skills, qualifications and often data of a personal and private nature.



Source 13.4 Record systems are set up to record data needed by the business.

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 they joined with BankLink to offer a cloud-based solution, including iPhone and Android apps.

Businesses can use MYOB to generate invoices and record receipts, and payment of bills can be linked to digital or scanned print copies of the original bill, so that the whole transaction is kept together. In keeping with the company's original philosophy, the package still uses ordinary, non-accounting terms like 'Money in', 'Invoices owed to me' and 'Sales targets'. From this information, the software can create reports necessary to the business, including profit and loss, balance sheets and GST reports. Many accountants like their clients to use MYOB, as all necessary data can be exported in a usable format.

Source 13.5 A company's annual financial report must be presented to shareholders.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 13.6 Financial managers need to assess the internal and external financial risks that a business faces each day.

Financial controls

Financial managers will need to put in place several financial controls that can be used to establish if 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.

Debt and equity financing

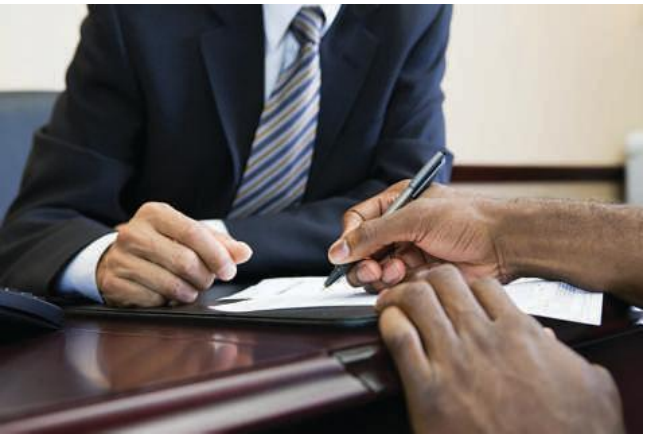
Debt finance is made up of borrowed funds. It involves a contractual agreement based on specific conditions over a period of time. The borrower will need to repay the principal (the initial amount borrowed) as well as pay interest. Most debt finance usually incurs administration fees and government charges such as stamp duty.

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.

Business Bite

ING Australia Holdings is a multinational insurance and finance company. A former ING senior financial accountant, Rajina Subramaniam, was charged with the misappropriation of approximately $45 million in 2009. Subramaniam was a trusted employee who had worked for the company for 20 years. During the last five years of her employment, she transferred funds from various corporate accounts at ING into her own personal accounts or directly to retailers and real estate agents. This was to pay for purchases of property she did not use and clothing and jewellery she often did not wear. Subramaniam used computer log-ins of staff who no longer worked at ING to delete or alter the records so that the transactions appeared to be legitimate.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 13.7 It is often easier for existing businesses to obtain loans.

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.

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 13.8 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.

Source 13.9 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Matching the terms and source of finance to business purpose

When managing finance, the accountant will distinguish between short- 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- 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.



Source 13.10 Non-current assets, such as property, should be purchased with long-term finance.

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.

Source 13.11 Comparison of short- and long-term debt finance

Type of debt	Length of loan
Short-term debt	
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 7 days; maximum of 90 days
Commercial bills	Average of 90 days but can be rolled over for additional months
Long-term debt	
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)

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.1 Comprehension

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.

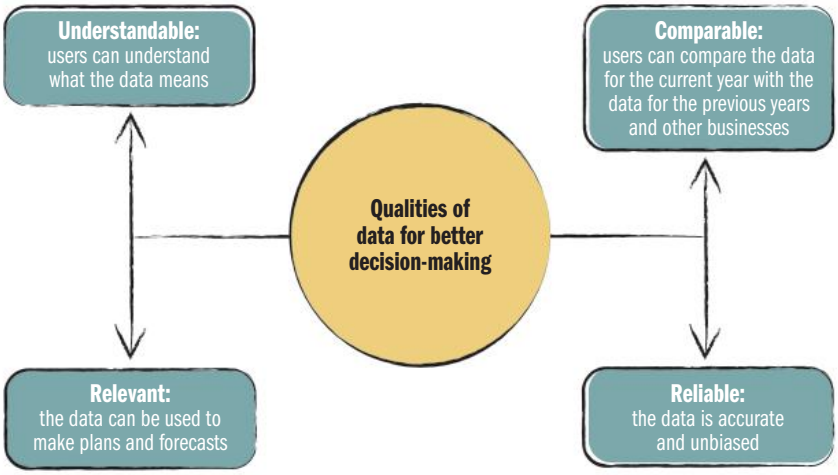
4 Outline three features of a company that a potential shareholder should consider before investing.

5 Identify factors that will influence an owner's choice of finance to expand the business.

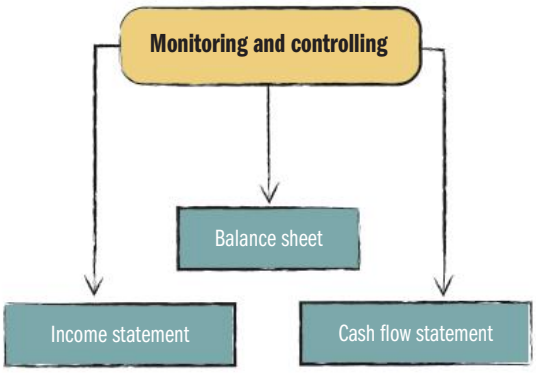
13.2 Monitoring and controlling

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.

There are three types of financial statements used for monitoring and controlling (see Source 13.12). 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.



Source 13.12 Data needs to have certain qualities to facilitate better decision-making.



Source 13.13 Financial statements used for monitoring and controlling

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.

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.

Insolvency Occurs when expenditure has exceeded income for an unacceptable length of time and the firm is unable to pay its debts.

Cash flow statement A financial report illustrating the movement of cash into and out of a business over time.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 13.14 Cash transactions are summarised in a cash flow statement.

Cash flow statement for Happy Pet Products Pty Ltd for the quarter ending 31 December 2017

	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**

Type of financial statement

Business name

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 13.15 Cash flow statement for Happy Pet Products Pty Ltd

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.2 Cash flow statement

Cash flow statement for Hazy Ski Hire Pty Ltd for the six months ending 31 December 2017

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6
	$	$	$	$	$	$
Opening Cash Balance	350	6100	2650	8500	(4600)	(2600)
Inflows						
Sales Receipts	12400	11200	10100	9500	9600	7800
Interest	300	300	300	200	200	100
Dividends	–	–	2400	–	–	–
Total Cash Inflows	12700	11500	12800	9700	9800	7900
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.

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 fourth month.
3. Describe the main reason the business went into negative bank balances.
4. Deduce the source of finance most appropriate for this business starting in month 4.
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 highest 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 reorganised 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Income statement for Happy Pet Products Pty Ltd for year ending 30 June 2017

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**

- Type of financial statement
- Inventory the business has at the beginning of the accounting period; i.e. at 1 July 2016
- Expenses incurred through the operations of the business. These are additional to the inventory
- 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
- The trading period covered by this report
- Total value of the goods sold by the business in the financial year
- Business name
- 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 2017
- Sales revenue less cost of goods sold

Source 13.16 Income statement for Happy Pet Products Pty Ltd

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.3 Income statement

Income statement for CDE Ltd for the years ending 30 June 2016 and 2017

	2016		2017	
	$	$	$	$
Revenue				
Sales – Goods	229 200		226 366	
– Services	9 550		7 250	
Total Sales Revenue		**238 750**		**233 616**
Less Cost of Goods Sold				
Opening Stock	85 450		56 106	
Plus Purchases	60 212		53 664	
	145 662		109 770	
Less Closing Stock	56 106	89 556	58 104	51 666
Gross Profit		**149 194**		**181 950**
Less Operating Expenses				
Selling	48 016		44 125	
Administration	75 861		67 599	
Financial	7 542	131 419	6 258	117 982
Net Profit		**17 775**		**63 968**

With reference to the income statement for CDE Ltd, complete the following questions.

1 Describe the changes between 2016 and 2017 to the following:

- **a** Total Revenue
- **b** Purchases
- **c** Gross Profit
- **d** Net Profit
- **e** Operating Expenses.

2 Outline possible reasons for the change in gross profit.

3 Assess whether this business was better off or worse off in 2017 compared to 2016. Why?

4 Identify the reasons why the net profit has increased from 2016 to 2017 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 28.5 per cent in 2016 and the current rate of 27.5 per cent for 2017, calculate the tax liability of this business for 2016 and 2017.

8 Calculate the net profit after tax for this business in 2016 and 2017.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 and long term. The balance sheet is sometimes referred to as the statement of net worth or a statement of financial position.



Source 13.17 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 2017

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 2017

Assets that generate revenue for the business over a period of more than 12 months

Net worth of the business; the owner's claim on the business

Net profit as calculated in the income statement

Debts the business owes and must pay within 12 months

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

Source 13.18 Balance sheet for Happy Pet Products Pty Ltd

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.4 Balance sheet

Balance sheet for CDE Ltd as at 30 June 2017

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 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.5 Comprehension

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'.

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 affect 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.6 Calculation and classification

1 Using the accounting equation, Assets = Liabilities + Equity, copy and complete the table below by calculating the missing figures.

Assets	Liabilities	Equity
6000		2000
5600	3100	
	2500	1673
	475	136
10790	9160	
25253	17253	

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.

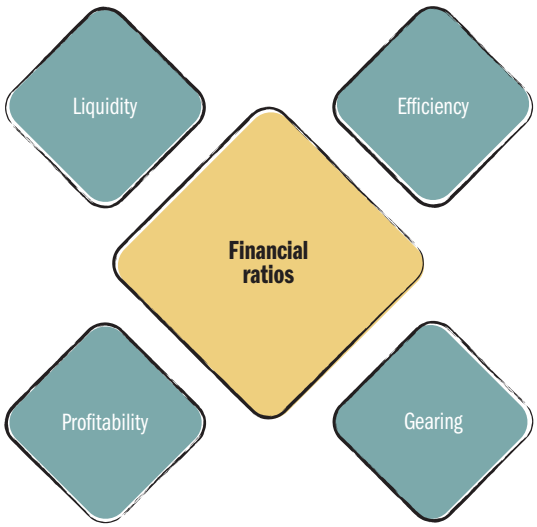
	Classification	Financial statement
a Sales		
b Cost of goods sold		
c Accounts receivable		
d Lease		
e Mortgage loan		
f Inventory or stock		
g Advertising		
h Interest paid on loans		
i Bank overdraft		
j Company car		
k Equipment		
l Land and buildings		
m Owner's capital		
n Accounts payable		
o Tax on net profit		
p Telephone		
q Accountant's fee		
r Wages		
s Cash		
t Insurance		
u Retained profits		
v Debentures		

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

13.3 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.

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 13.19 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.

$$\text{Debt to equity ratio} = \frac{\text{Total Liabilities}}{\text{Total Equity}}$$

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

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Source 13.20 Financial ratios

Ratio type and name	Formula	Results from analysis of CDE Ltd income statement & balance sheet 2017 example in Activities 13.3 and 13.4	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 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 their solvency. Generally, a business should have more equity than debt; however, it depends on the industry involved.
Profitability			
Gross profit ratio	$\frac{\text{Gross Profit}}{\text{Sales}}$	77%; for every $1 of sales $0.77 is made in gross profit	The higher the ratio the better.
Net profit ratio	$\frac{\text{Net Profit}}{\text{Sales}}$	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 their efficiency.
Return on equity (ROE)	$\frac{\text{Net Profit}}{\text{Total Equity}}$	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.
Efficiency			
Expense ratio	$\frac{\text{Total Expenses}}{\text{Sales}}$	50.5%; for every $1 of sales $0.505 is spent on expenses	The lower the ratio the more efficient the business is.
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.

25 per cent is described as having low gearing. As 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.

Otherwise the business must make repayments with a higher interest expense from falling profit. Profit

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 13.21 Business profits fall as sales fall during periods of slower economic growth.

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.

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, 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).

$$\text{Gross profit ratio} = \frac{\text{Gross Profit}}{\text{Sales}}$$

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.

$$\text{Net profit ratio} = \frac{\text{Net Profit}}{\text{Sales}}$$

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.

$$\text{Return on equity} = \frac{\text{Net Profit}}{\text{Total Equity}}$$

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.

$$\text{Expense ratio} = \frac{\text{Total Expenses}}{\text{Sales}}$$

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.



Source 13.22 A retailer aims to sell inventory as quickly as possible.

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 Ltd 2017 in Activity 13.4. Using the figures for sales in Activity 13.3 and accounts receivable in Activity 13.4, 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.

$$\text{Accounts receivable turnover ratio} = \frac{\text{Sales}}{\text{Accounts Receivable}}$$

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.

Activity 13.7 Comprehension

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.

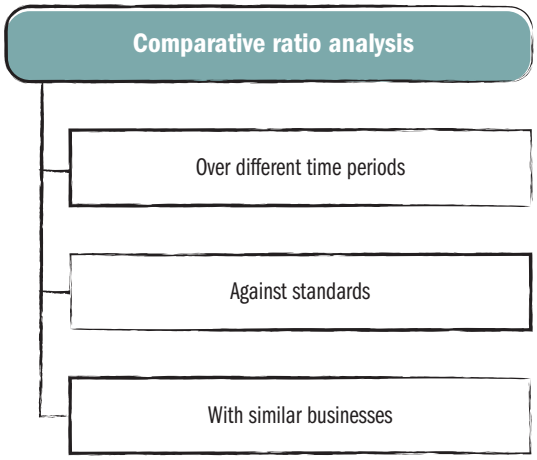
3 Using the income statement for CDE Ltd for 2016 and 2017 (Activity 13.3), calculate for 2016:
   - a Gross profit ratio
   - b Net profit ratio
   - c Selling expenses ratio
   - d Administration expenses ratio
   - e Financial expenses ratio.

4 Compare your results for Question 3 with the results in the summary table of ratios providing 2017 results. What changes can you identify?

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 13.23 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, 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



Source 13.24 Benchmarking is comparison with other businesses and established standards in the industry.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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. 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 13.8 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 2017			
	2015	**2016**	**2017**
	$	**$**	**$**
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 2015, 2016 and 2017. Comment on the changes.

2 Calculate an efficiency ratio using total expenses for 2015, 2016 and 2017. Comment on the changes.

3 Extrapolate any possible reasons for the decrease in gross profit in 2017.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 13.9 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 2017 balance sheet to the figures for 2016. 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 2016 and 2017		
	2016	2017
	$	$
Current Assets		
Cash	1 000	1 000
Accounts Receivable	2 000	4 000
Inventory	15 000	15 000
Total Current Assets	18 000	20 000
Non-current Assets		
Equipment	12 000	13 000
Motor Vehicles	36 000	43 000
Total Non-current Assets	48 000	56 000
Current Liabilities		
Bank Overdraft	2 000	1 000
Accounts Payable	4 000	9 000
Total Current Liabilities	6 000	10 000
Non-current Liabilities		
Mortgage Loan	40 000	37 000
Total Non-current Liabilities	40 000	37 000
Equity		
Capital	10 000	10 000
Plus Retained Profit	16 000	23 000
Less Drawings	6 000	4 000
Total Equity	**20 000**	**29 000**

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

13.4 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. 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

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 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

Normalised earnings
The earnings adjusted to take into account cyclical upswings or downswings in the economy, or to remove one-time influences.

Capitalised expenses
The costs incurred when financing a non-current asset added to the cost of the asset.



Source 13.25 Financial reports have a number of limitations.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

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.



Source 13.26 Business assets such as motor vehicles depreciate in value over time through wear and tear.

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 Bite

In January 2016, Stephen Mayne wrote an article for Crikey.com.au titled 'Mayne: stand by for big company asset write-downs'. This article highlights some of the issues that face companies relating to their valuation of assets and how some are well above and others below their current market value. The article gives six examples from the media sector:

Company	Market cap	Book value
APN News and Media	$530 million	$481 million
Fairfax Media	$2.12 billion	$2.07 billion
Seven West Media	$1.25 billion	$1.2 billion
Southern Cross Media	$830 million	$936 million
Nine Entertainment Company	$1.5 billion	$1.08 billion
Ten Network Holdings	$546 million	$412 million

A write-down is the accounting term used to describe a reduction in the book value of an asset due to economic or fundamental changes in the asset. One example is when one company purchases another and pays more than the net fair value of its assets and liabilities. In January 2016, BHP Billiton took a $10.3 billion write-down on its US onshore oil and gas assets – the biggest single write-down in Australian history. This was mainly a result of the drop in oil prices, although a weakness in gas prices was also significant, as well as currency being down. The $92.1 billion book value was no longer a true reflection of the assets.

In 2001, two Australian companies – One.Tel and HIH Insurance – collapsed, even though their final published balance sheets claimed strong net assets: $945 million for One.Tel and $953 million for HIH Insurance.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 to 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.

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** and brand names.

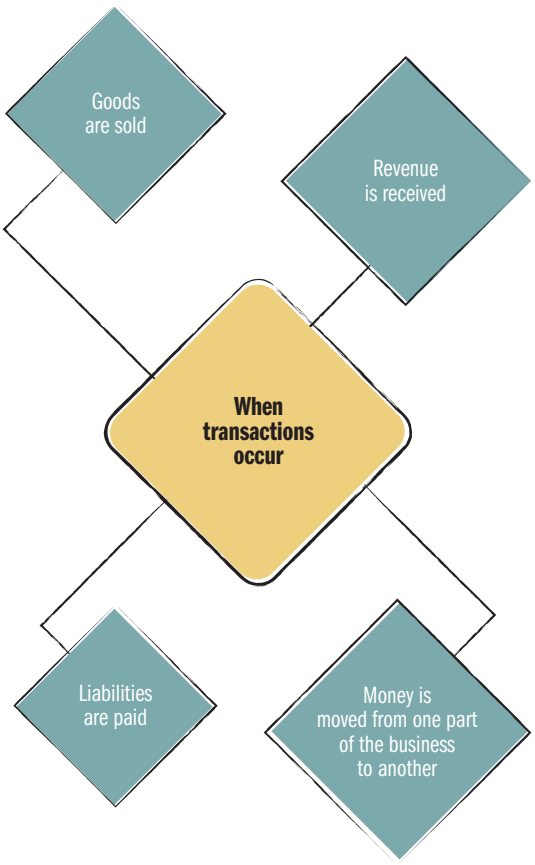
Patents are the legal protection a business can obtain to prevent other businesses copying its ideas. Although **goodwill** is an intangible asset, it is often included as a balance sheet item when a business is to be sold. The business may have regular customers who are loyal and guarantee the business 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 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 sold that are under **warranty**.

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, etc. 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 13.27 When transactions occur

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.

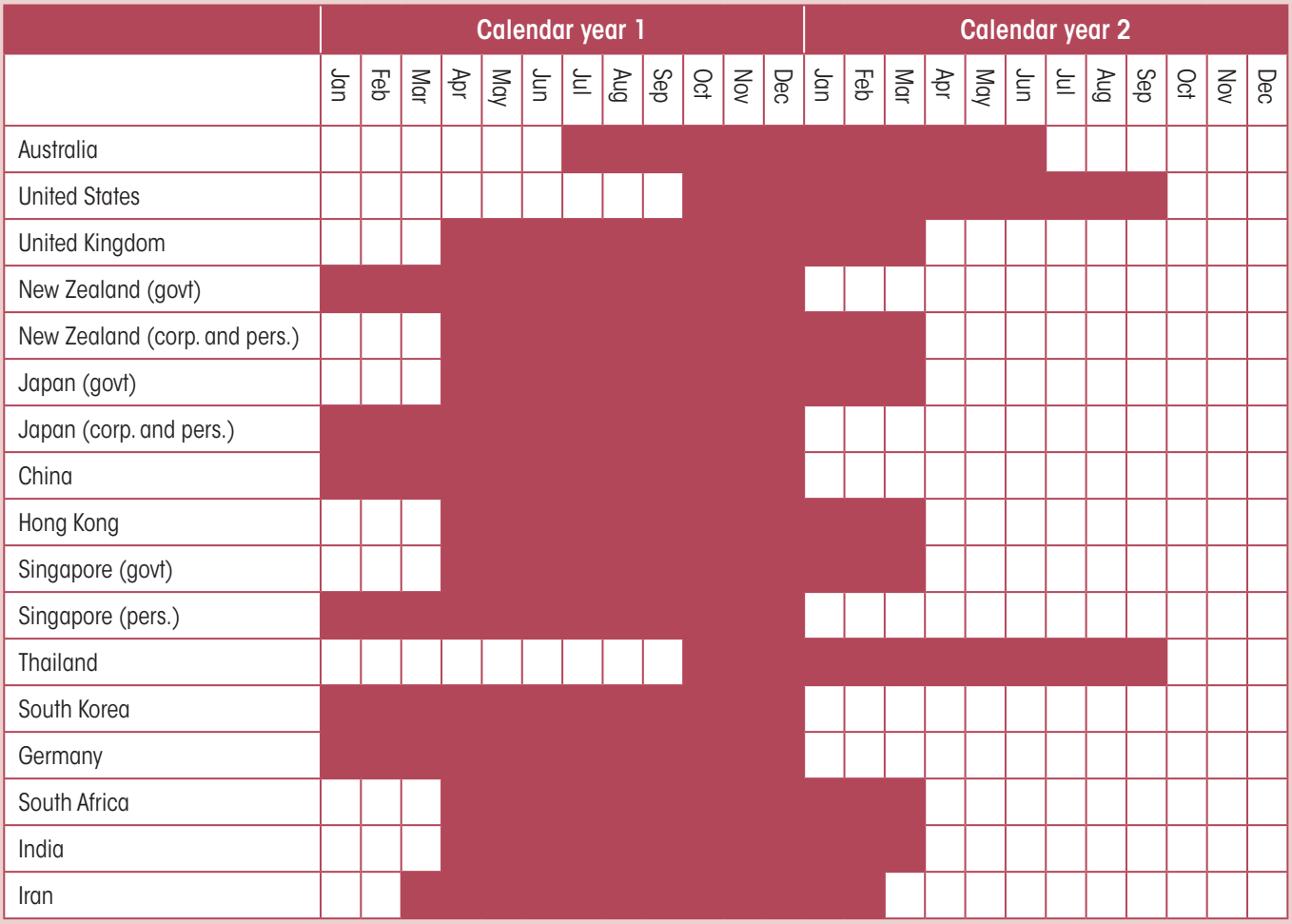
Goodwill An intangible asset valued according to the advantage or reputation a business has acquired over time.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 13.28 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'. Business 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

The Qantas Frequent Flyer program has over 500 partners and includes Budget, David Jones, eBay and British Airways passengers. However, it does have a membership fee in Australia and New Zealand, although it is free in other countries. 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 airlines sell the points for more money than it cost to redeem them, the airline benefits. It is estimated that Qantas earned approximately $1.3 billion for its points over the last five years.

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 would provide a deeper understanding of the transaction, how they were calculated and why it was recorded in a particular way. However, even though these notes provide relevant information, they may be numerous and lay people may not find all of them understandable.

13.5 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. The Institute of Chartered Accountants Australia 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 cannot '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 Ansett, HIH Insurance, One.Tel and ABC Learning Centres were all unexpected. Many thousands of employees lost their jobs overnight. Investors lost their assets, while senior executives received enormous payouts despite 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.

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.



Source 13.29 Improved internal controls could curb the unethical use of company funds.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

This is an unethical use of company funds. Improved internal controls could eliminate this problem.

Businesses can act in a more socially responsible and ecologically 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 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.

Triple bottom line (TBL) A measure of a business's financial, social and environmental performance.

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.

Business Bite

The ATO investigates businesses and can issue fines and take criminal action against tax offenders. Under its Project Wickenby task force, the ATO recouped more than $2.2 billion in tax liabilities and had 46 convictions of individuals up to 30 June 2015. The ATO also prosecuted another 69 people, mostly involving outstanding tax lodgements. Following Project Wickenby, the ATO set up the Serious Financial Crime Taskforce, beginning on 1 July 2015 with a focus on international tax evasion. Most cases are heavily publicised to act as a deterrent to people thinking no one gets caught. The ATO encourages members of the community to report tax fraud by phone or through its online facility.

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.

Activity 13.10 Comprehension

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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, GST, BAS, executive salary based on performance, and the triple bottom line.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 draws $5000 from the business.
- **b** The business purchases a new van using a long-term loan for $25 000.
- **c** The business buys additional stock for $5500 from its suppliers using trade credit.

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.

9 Explain why tax evasion is considered not only illegal but also unethical.

Multiple-choice questions

1 Which financial statement best gives an indication of a business's net worth?

- **A** Cash flow statement
- **B** Gearing report
- **C** Income statement
- **D** Balance sheet

2 What is the liquidity ratio used to measure?

- **A** The value of current liabilities in a business
- **B** The value of current assets in a business
- **C** The ability of a business to pay its current liabilities
- **D** How much cash there is in a business

3 What is the purpose of financial ratios?

- **A** To analyse the financial performance of a business
- **B** To calculate business expenses
- **C** To further summarise the financial statements
- **D** To estimate the financial performance of a business

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 What are business ethics?

A Acting in a socially responsible and morally appropriate way
B Acting to protect the interests of internal stakeholders
C Acting in the financial interests of the owners
D Producing environmentally safe products

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 What does the accounts receivable turnover ratio measure?

A Profitability
B Gearing
C Efficiency
D Liquidity

10 Removal of cyclical effects on revenue or a one-off occurrence in reports is called:

A capitalising expenses
B normalised earnings
C fraud
D timing issues.

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 and protect the financial interests of internal stakeholders.

Extended-response question

Evaluate how and why a business would manipulate its financial reports.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

14 Financial management strategies

Chapter objectives

In this chapter, students will:

- investigate financial management strategies
- 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
- depreciation
- 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

14.1 Introduction

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:

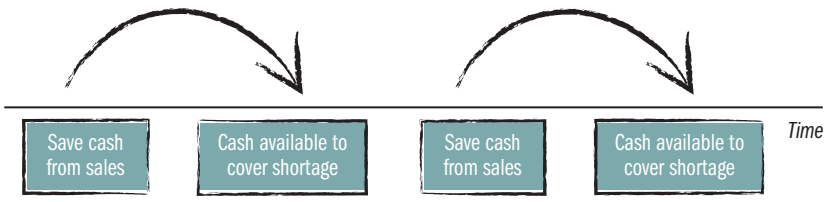
- make effective and efficient use of resources
- achieve objectives and fulfil commitments to stakeholders
- become more accountable to stakeholders
- gain the respect and confidence of the community
- gain an advantage over its competitors
- prepare for long-term financial sustainability.

The four main areas for financial management strategies include cash flow management, working capital management, profitability management and global financial management.

14.2 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.

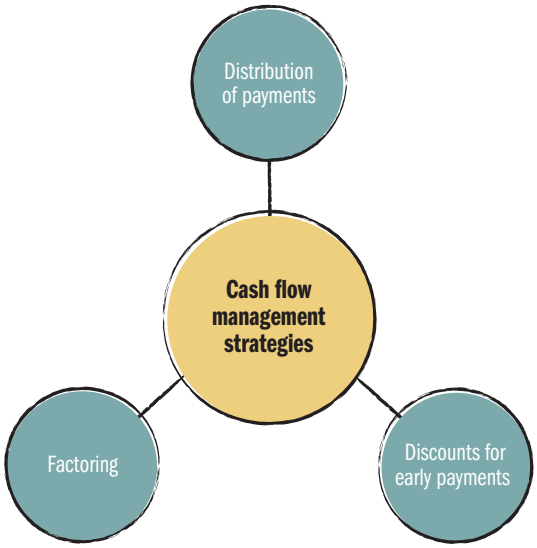


Source 14.1 Managing cash flow

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.

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.



Source 14.2 A number of strategies can be used to manage cash flow.

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 14.3. 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

to by the bank. Interest is charged daily on the balance outstanding. (For more detail on cash flow statements, refer to Chapter 13.) 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.

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.

Source 14.3 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	

Activity 14.1 Comprehension

1. Define the term 'cash flow'.
2. Explain the impact on cash flow of leasing equipment compared with purchasing equipment.
3. Evaluate the benefits to cash flow of using just-in-time (JIT, described in Chapter 4) inventory control systems.
4. What period does the cash flow statement usually cover? Why does this period vary?
5. What factors would a manager need to consider when preparing a cash flow statement?
6. Suggest how a cash flow statement can be used as a planning tool and a control tool.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 14.2 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.

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.



Source 14.4 A business may offer discounts to account customers (debtors) for early payment of their accounts.

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.

Business Bite

NAB Invoice Finance is a factoring service, and one of the leading providers of invoice finance to Australian businesses. The business is not required to provide mortgage security for the finance, and approvals can be made within one business day. Factoring is available for up to 80 per cent of the value of unpaid invoices.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

14.3 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:

$$\text{Working capital ratio (current ratio)} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

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.

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.

Working capital The current assets used in the day-to-day running of a business and to pay current liabilities that fall due.

Control of current assets

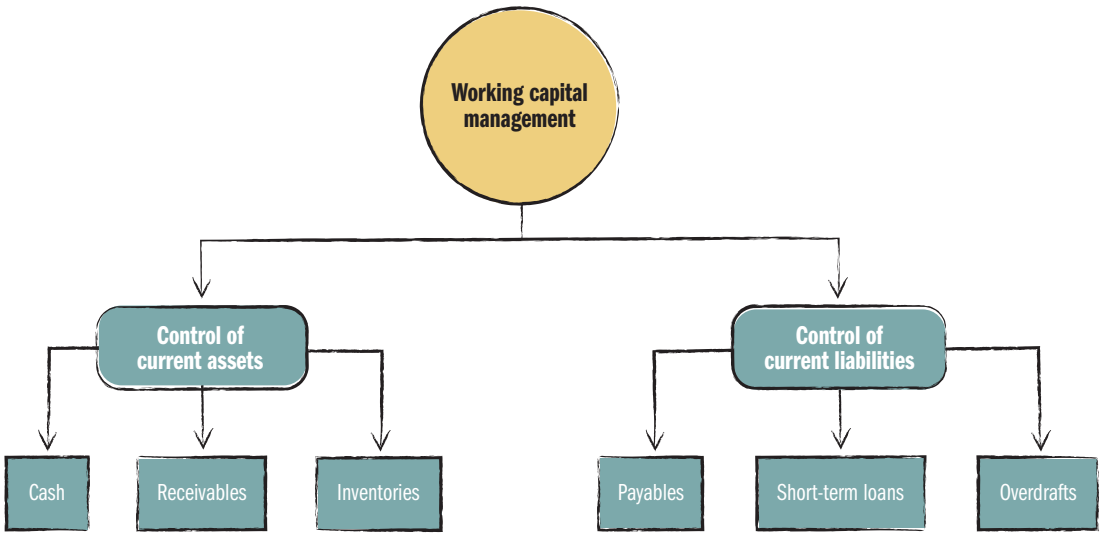
Control of current assets involves ensuring there are enough liquid assets to pay current liabilities when they fall due. These more liquid assets can be readily converted into cash within a 12-month period. The three most common current assets are cash, accounts receivable and inventory. The role of 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



Source 14.5 Strategies in working capital management

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 14.7, 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 14.6 Cash is the most liquid form of asset.

Source 14.7 Worked example of working capital ratio

	$		$
Current assets		**Current liabilities**	
Cash	1 000	Bank overdraft	1 500
Accounts receivable	2 000	Accounts payable	500
Stock	1 000	**Non-current liabilities**	
Non-current assets		Mortgage loan	50 000
Equipment	10 000	**Equity**	
Building	86 000	Capital	48 000
Total assets	**100 000**	**Total liabilities + equity**	**100 000**

Receivables

Receivables or accounts receivable are 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- 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.

Activity 14.3 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		

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 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 14.4 Comprehension

1. Outline the three most common current assets that many businesses own.
2. Discuss why accounts receivable is classified as a liquid asset.
3. Explain why a business needs to have more current assets than current liabilities.
4. Clarify why is it considered inefficient to have large cash reserves.
5. Justify why a business can offer discounts for early payment but cannot freely impose a late penalty fee on account customers.
6. Recommend when a business should enter into a lease agreement rather than purchasing an asset.

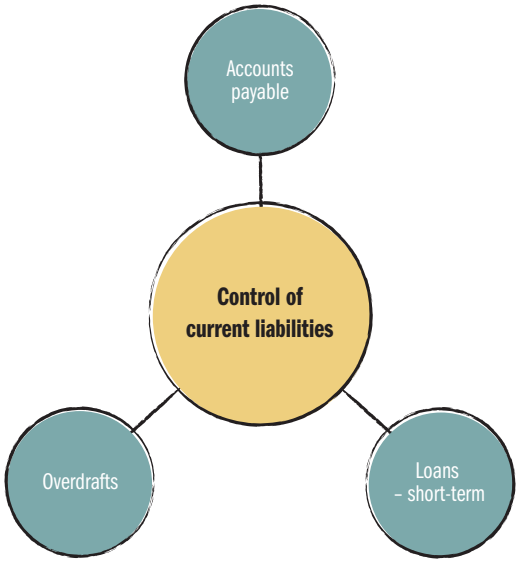
Source 14.8 Security measures help protect a business's inventory.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 14.9 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 7, 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.

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 14.10 Businesses rely on payables or accounts payable to ensure that suppliers are paid on time, and so that cash flow is not negatively affected.

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+.

Loans

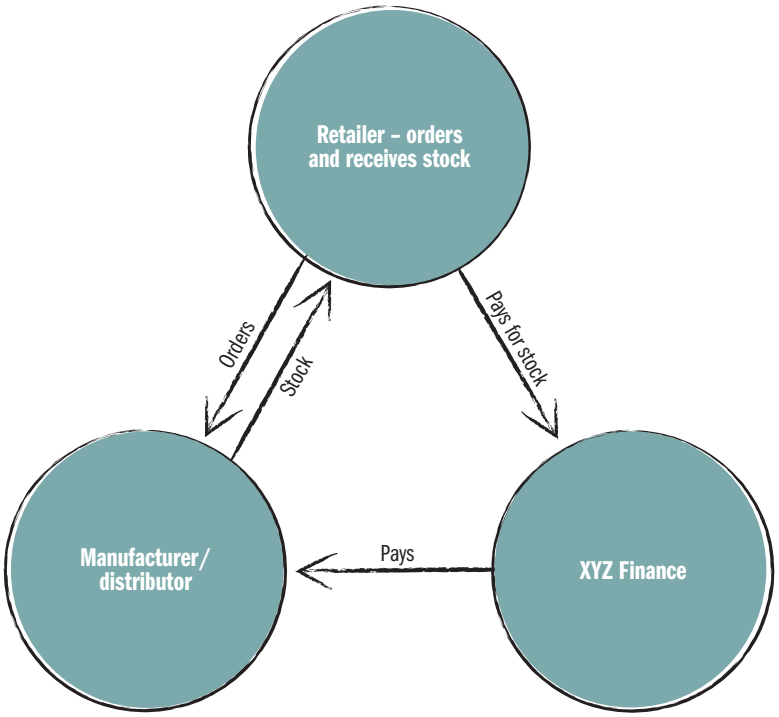
The business must compare the costs and term of the loan with other sources of finance, such as leasing, in order to use the most appropriate form of finance for short-term needs.

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

repayments on time, as continued late payments may create issues for future access to debt finance.

Many financial institutions offer short-term loans to businesses for amounts up to $100 000 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 6.55 per cent to 19.99 per cent, depending on the benefits attached to the card and if security has been provided.



Source 14.11 Floor plan funding

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.



Source 14.12 Online banking systems give financial managers access to the business's bank accounts at all times.

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:

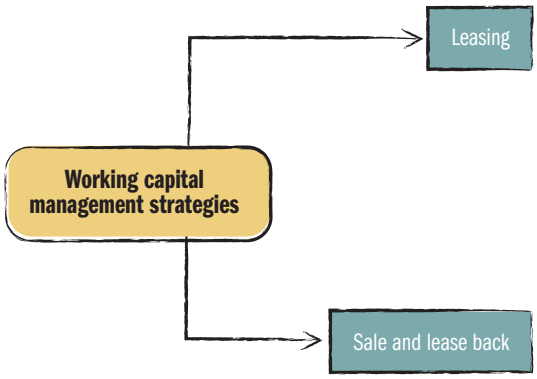
- adjusting the terms in their loan contract to meet their current situation
- extending their loan period
- allowing them to make smaller payments over a longer period of time
- postponing payments for an agreed period.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 furniture and vehicles. Additionally, the lease payments will be an expense and 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.



Source 14.13 Strategies for working capital management

Sale and lease back

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.

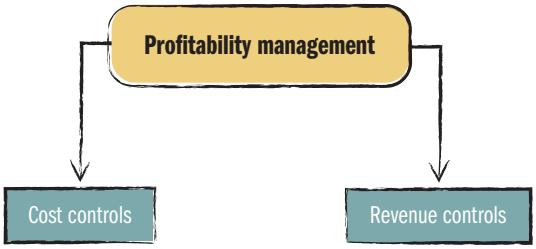


Source 14.14 Vehicles used for business are frequently leased.

14.4 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.

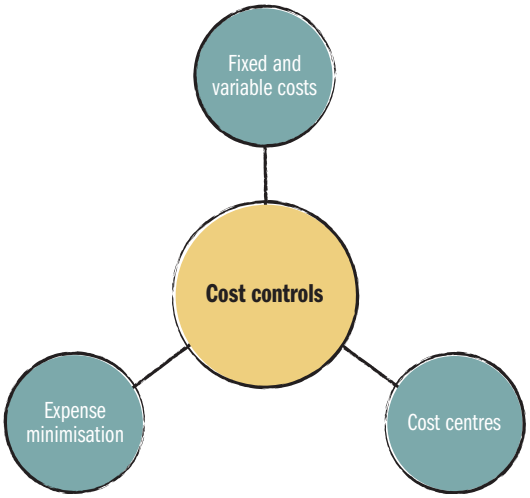


Source 14.15 Controls in profitability management

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



Source 14.16 Different cost controls

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

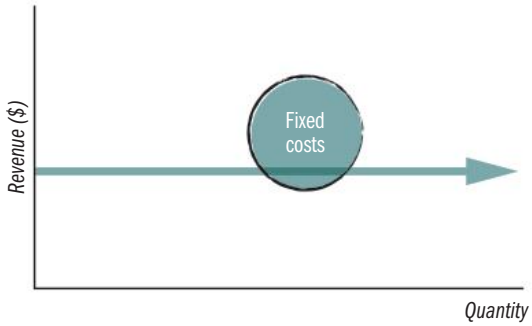
Insurance premium The cost of obtaining insurance. The premium is based on the risk of the insured event actually occurring.

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.

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.

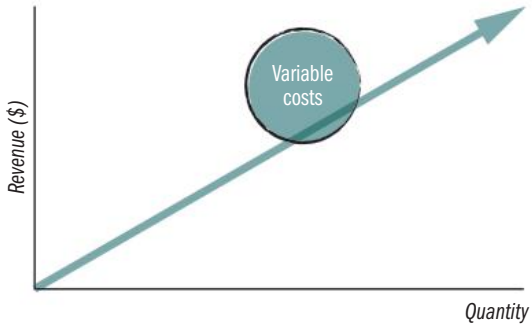
Examples of fixed costs are management salaries, rent, lease payments, fixed-interest payments on loans, **insurance premiums**, rates and government fees. Fixed costs are often contract-based and negotiated before production and sales have begun; hence, they are harder to reduce and must be paid.



Source 14.17 Fixed costs

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 (where an expense does not add value to the product or service the business provides).



Source 14.18 Variable costs

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 was forecasted in the budget and what the actual figures were. They can also be compared to industry averages.

Source 14.19 Examples of fixed costs, variable costs and on-costs of labour

Fixed costs	Variable costs	On-costs
Loan repayments	Electricity and gas	Superannuation
Insurance	Phones	Annual leave
Lease payments	Raw materials	Allowable family and community services/sick leave
Salaries	Stationery	Payroll tax
Rent	Piece rate labour commissions	Public holidays
	Credit card fees	Workers compensation insurance
	Freight/delivery charges	Annual leave loading
	Petrol	Casual loading
	Costs of goods sold	Maternity leave

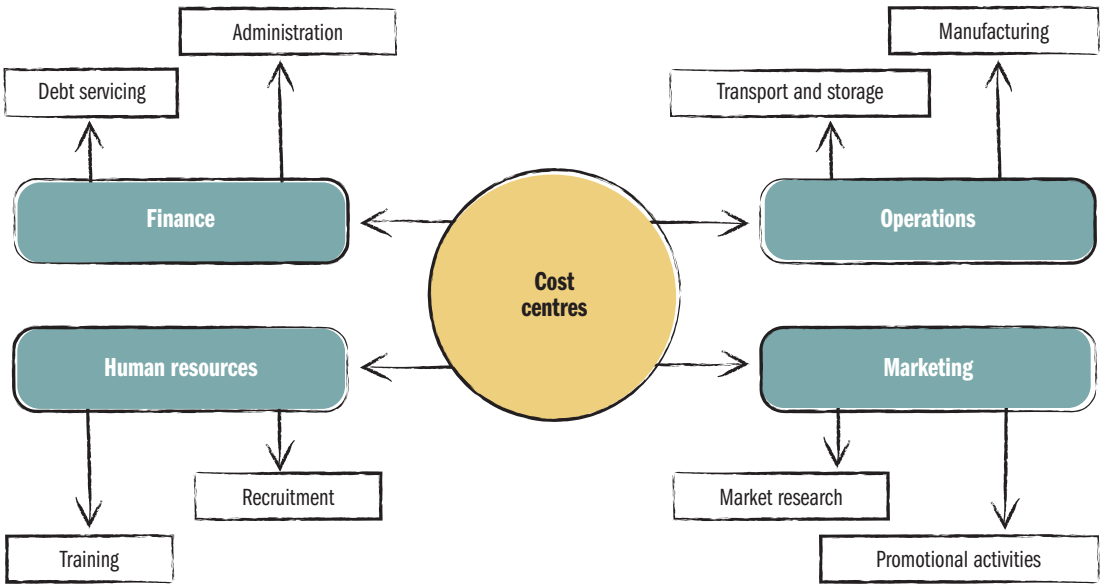
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 14.20 Examples of individual cost centres within departments

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



Source 14.21 Some businesses have minimised their expenses by replacing some staff with machinery, such as in the automotive industry.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

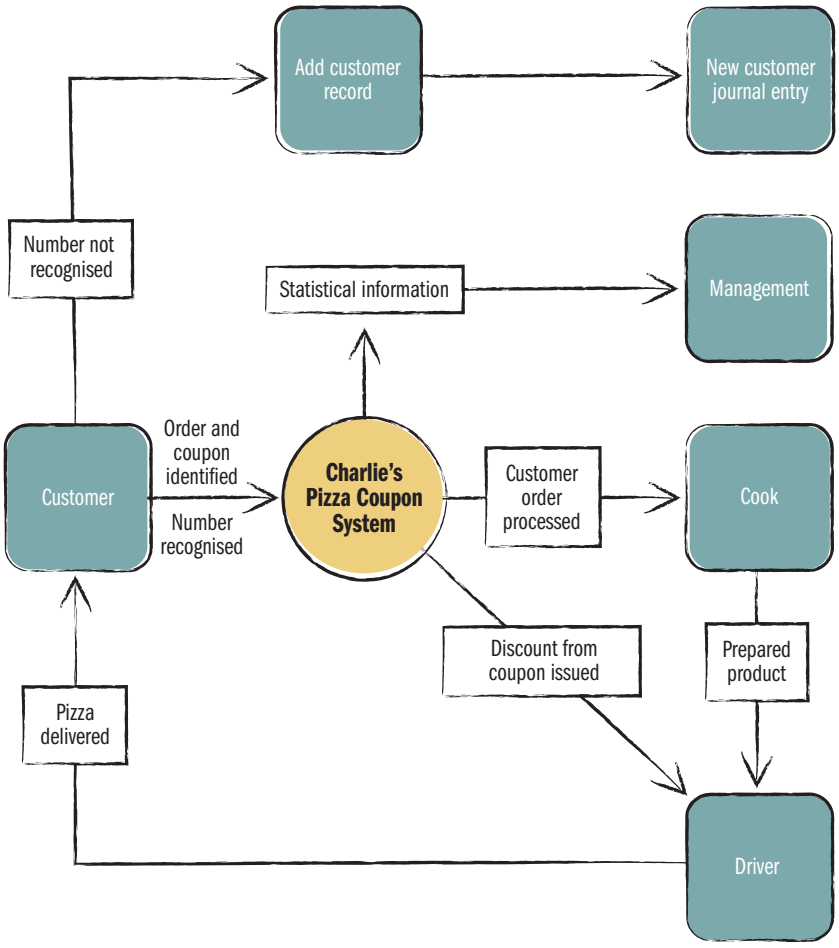
- substitute machinery for labour
- downsize middle management.

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. 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 is shown in Source 14.22.

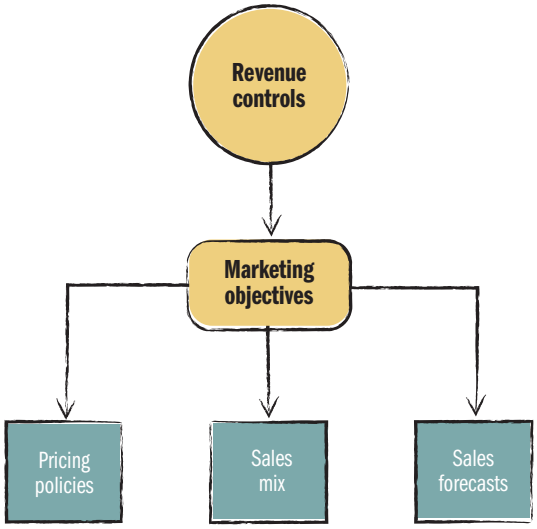


Source 14.22 Flow of products and money for Charlie's Pizza Coupon System

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.



Source 14.23 Revenue controls can be used to achieve marketing objectives.

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 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Business Bite



Some businesses change product size or recipe 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**
- **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 47g to 24g**
- **Cadbury – changed the recipe of its 39g Creme Egg**
- **Coca-Cola's New Coke – reverted to its original recipe**
- **Campbell Soups – reduced the sodium in cans of soup**
- **Tim Tams – kept the classic but introduced 'limited edition' varieties**
- **Toblerone – fewer triangles per bar, with 170g bars reduced to 150g and the larger bar reduced from 400g to 360g**

Activity 14.5 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

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Activity 14.6 Comprehension

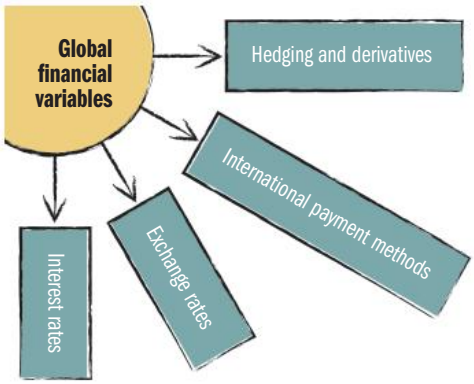
1. Discuss the difference between cash flow and working capital.
2. Draw a graph illustrating fixed costs and variable costs. Then add a 'total cost' curve. (Hint: total cost = fixed cost + variable cost.)
3. Define cost centres.
4. Recall why cost centres are useful for profitability management.
5. 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.

14.5 Global financial management

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.

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.



Source 14.24 Global financial variables 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 14.25 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Source 14.25 Comparison of value of AUD with USD, euro and Japanese yen, 1980–2017

Year	1 AUD buys USD	1 AUD buys euro	1 AUD buys yen
	(monthly average)	(monthly average)	(monthly average)
1980	1.0831	Not yet introduced	270.13
1985	0.7051	Not yet introduced	176.94
1990	0.7542	Not yet introduced	118.79
1995	0.728	Not yet introduced	64.92
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
The values are the averages for the month of March			

Source: Reserve Bank of Australia website.

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 1.05 USD in 2012. Since then the value has decreased and settled around 76 cents in 2017.

Activity 14.7 Research

There are many websites that do currency conversions. The OANDA website also shows historical exchange rates. Go to the OANDA site, select Historical Rates from the Currency Converter menu, and then fill in the currency and date details for a graphical presentation for the US dollar, the euro and the yen.

You can also put in other countries and time periods to obtain graphs for a history of their exchange rate changes.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Appreciation An upward movement or increase in value of the Australian dollar compared to any other currency.

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.

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.

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.

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.

Source 14.26 Exchange rates can be a risk to businesses.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- 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

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

Activity 14.8 Comprehension

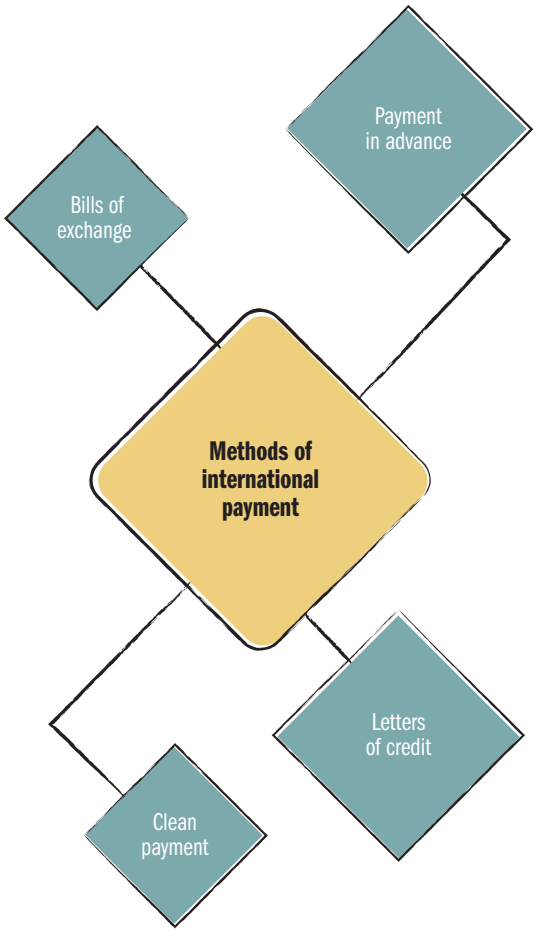
1. Identify which currencies are currently the most popular for trading internationally.
2. Discuss whether a country always trades in its own currency.
3. Identify currencies that a trading country may not want to trade in at present. Justify your response.
4. Explain why currencies of different countries 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 genuine 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Payment in advance
Method of payment in which the goods are actually paid for before they are supplied.

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 14.27 The main methods of international payment

Payment in advance

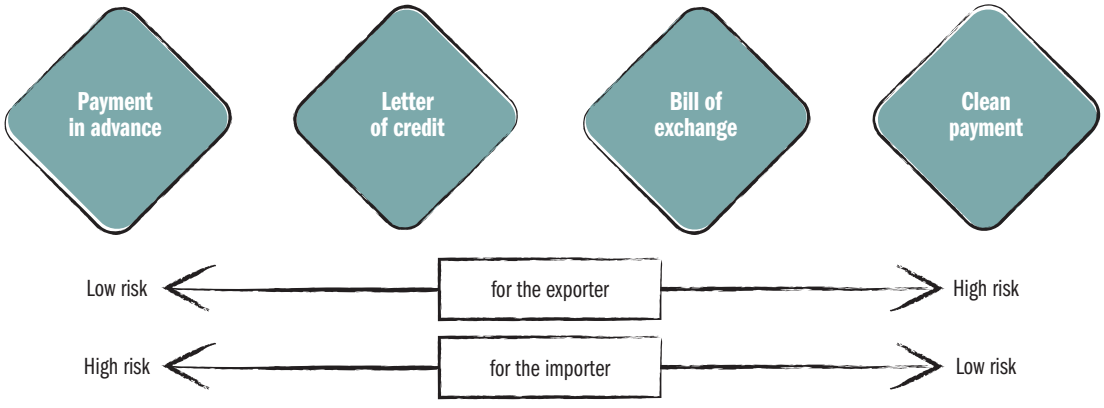
The most secure method of payment, where the exporter bears the least risk, is for the exporter to receive **payment in advance**. However, this will be the least desired option for the importer, as it has all the risk of the goods never being sent.

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.

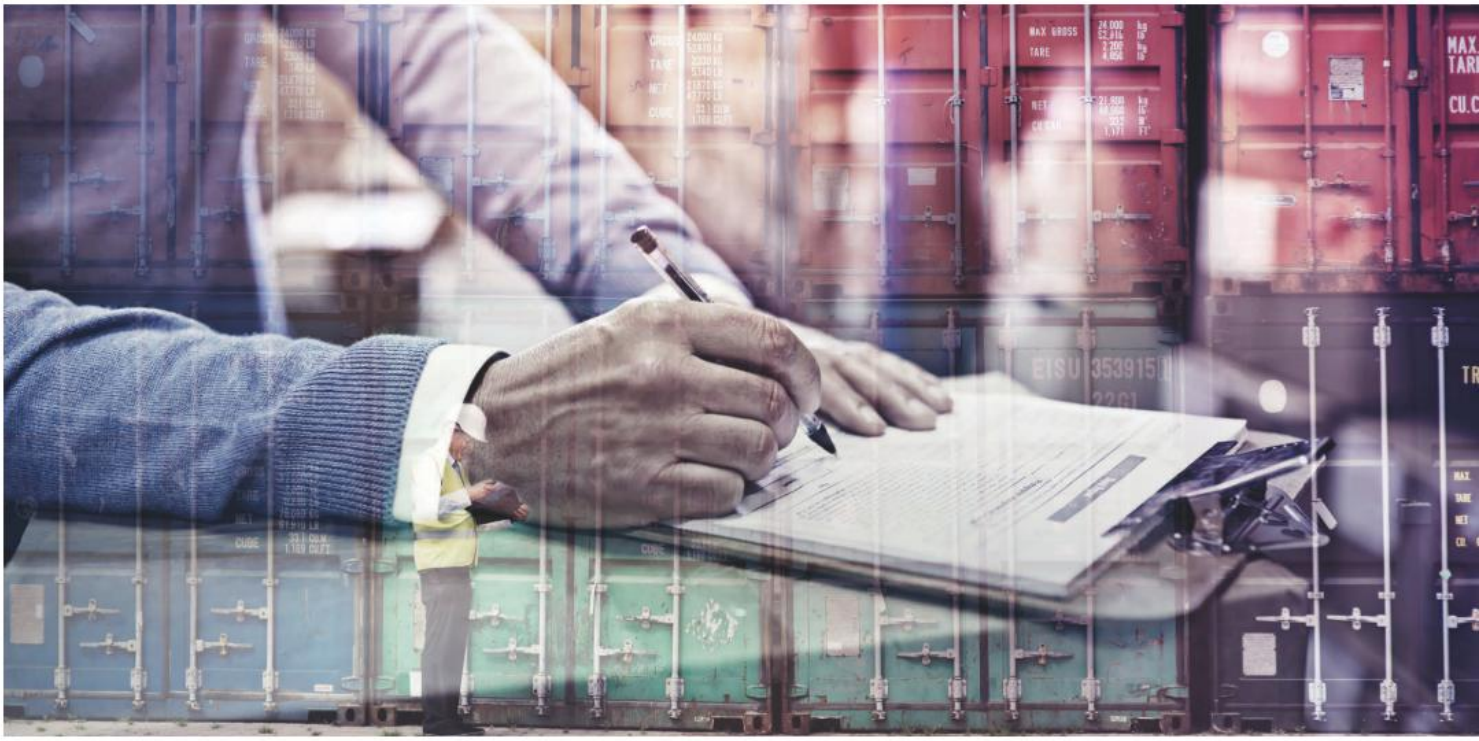
Bill of exchange

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, 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 14.28 Level of risk of payment methods

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 14.29 The international export and import of goods will often require a bill of exchange to pass from the exporter (when they send the goods) to an international bank, and then on to the importer (when they receive 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 of 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.

Activity 14.9 Comprehension

1 Identify the risks to an importer if a prepayment is used.

2 Define insurance. Explain how it can reduce financial risk.

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

Hedging Any strategy or financial tool used to reduce the risk of loss resulting from financial transactions, such as converting one currency to another.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Subsidiary A business that is partly or completely owned by another company.

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 manufacturer 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.

Business Bite

Since 2000 the global financial market has seen volatility in commodity prices and exchange rates and 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. These will allow an airline to lock in a specific price and create an upper limit or ceiling price or a lower limit or floor price that will reduce fluctuations in the cost of its fuel. Fuel prices and exchange rates can move up or down and either benefit or disadvantage the buyer. If an airline has locked in a price through hedging, it cannot take advantage of favourable movements and competitors can. However, the airline now has a specific price on which to base its future planning.

Derivatives

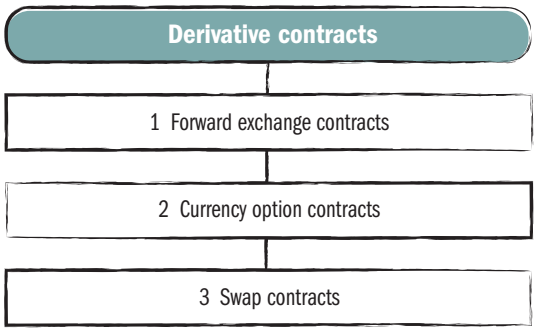
Derivative A contract under which the buyer agrees to purchase something from the seller for a set price at a future point in time. It can be used to hedge (that is, reduce) financial risks, such as those created by the appreciation and depreciation of currencies.

A 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.

A common use of derivatives is to reduce currency risk between global businesses and suppliers. The main types of derivatives are shown in Source 14.30.

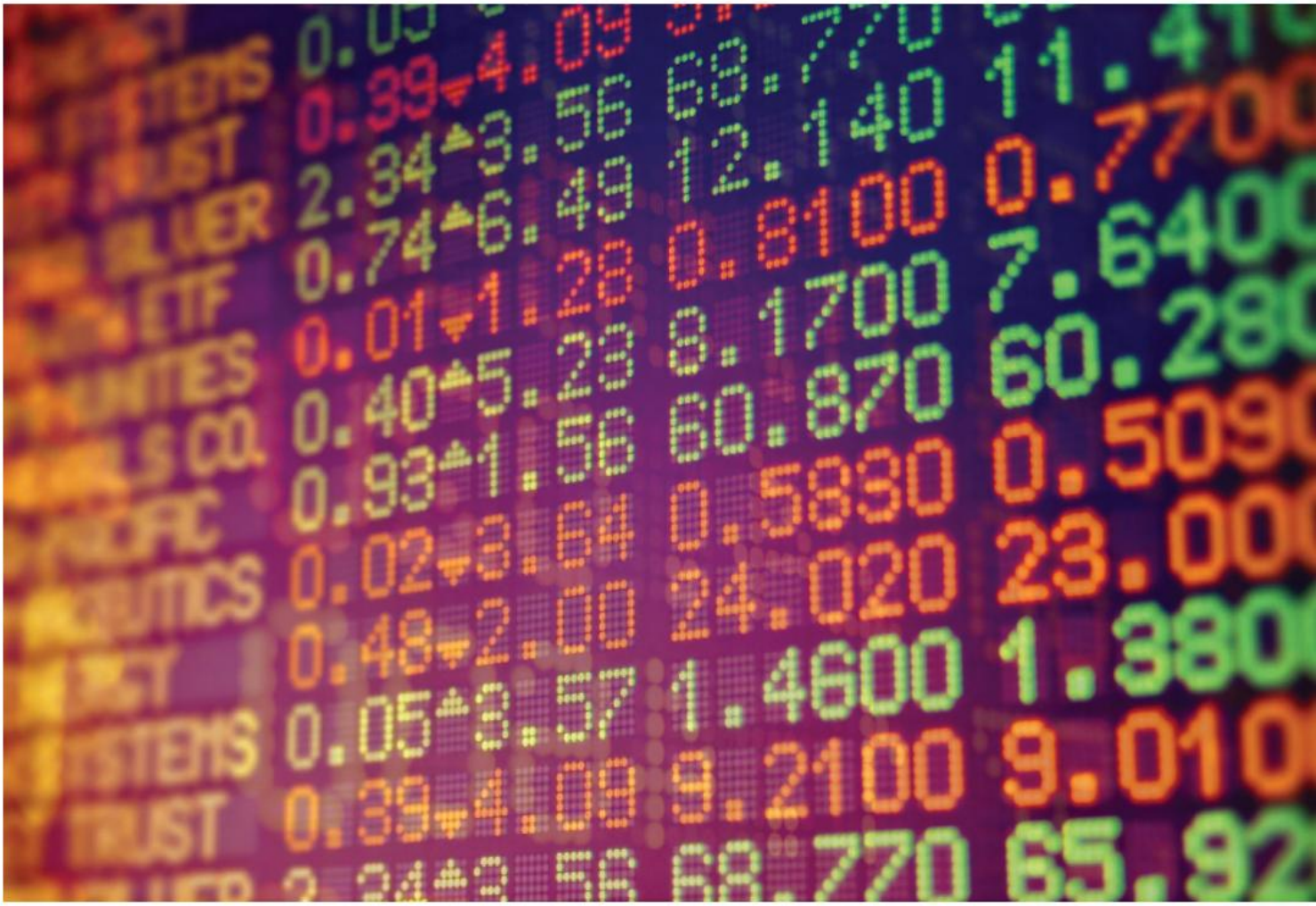
By using a forward exchange contract the bank will guarantee the exporter an agreed exchange rate on a certain date in the future. The exporter will be able to make an accurate forecast of its revenue from the sale of the exported goods as well as the importer an accurate costing. This rate will be paid regardless of what the exchange rate actually is on the agreed date.

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 14.30 The three main types of derivative contracts

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 14.31 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.

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.

Activity 14.10 Comprehension

1. Define the term 'hedging'.
2. Outline the strategies a global business may use to hedge against payment risks.
3. Evaluate the advantage of a currency option contract.

Activity 14.11 Comprehension

1. Outline the effect of changes in the value of currencies on the financial planning of a global business.
2. Explain the role international banks have in reducing payment risk.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 lease back.

Short-term loans should be used for short-term needs.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision tasks

1 Select terms from the list provided to best complete the following passage.

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 lease back.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 What are cost centres used to determine?

A Which costs in the business are the highest
B The contribution to total costs of different sections of a business
C Which products bring in the most revenue
D Which machinery needs replacing

4 What value can be used to determine the liquidity of a business?

A The amount of cash held by the business
B The working capital or current ratio
C The value of all assets held by a business
D The value of all liabilities of a business

5 Which asset would take the longest to become liquid?

A Cash
B Debtors
C Non-current assets
D Work in progress

6 Which of the following is an inventory management system?

A Barcodes
B ASIC
C ATO
D JIT

7 In Business Studies, accounts receivable is referred to by another term. What is this term?

A Suppliers
B Prepaid expenses
C Creditors
D Debtors

8 It has been recommended to Reginald that he use factoring. Which of the following best explains what factoring is?

A The selling of a business's current debtors to a specialist debt-collecting firm
B The selling of a business's current liabilities to a specialist debt-collecting firm
C A business reducing its total liabilities
D A business increasing its total assets

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

9 What is the most appropriate strategy for a financial manager to use for debt finance?

A Obtain short-term loans instead of long-term loans
B Ensure that debt is only used to purchase non-current assets
C Organise the repayment of loans over as many years as possible
D Shop around for the lowest interest rates and most suitable repayment terms for the business

10 Why do currency fluctuations represent a financial risk to business?

A Interest rates can increase without warning.
B Conversion from one currency to another can result in lower revenue and higher expenses.
C International banks impose transaction fees.
D Tourists will require more spending money.

Short-answer questions

1 Discuss the advantages and disadvantages of leasing equipment compared with buying.

2 Copy Source 14.32 and then complete it by calculating the closing balance for January to April and the opening balance for February, March and April for Greg's Motorcycle Parts Warehouse Pty Ltd.

3 Identify the trend in sales revenue for Greg's Warehouse.

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.

Source 14.32 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				

Extended-response question

Evaluate why it is important for a business to develop financial strategies to maintain its liquidity.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

15 Finance at Domino's

Chapter objectives

In this chapter, students will:

- investigate the role of financial management at Domino's
- analyse the influences on financial management at Domino's
- explain the processes of financial management at Domino's
- evaluate financial management strategies at Domino's.



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

15.1 Role of financial management

Domino's Pizza Enterprises Limited (DPE Ltd) is an Australian publicly listed company. The company has achieved a profit of $125 819 000 for 2016. Strong sales and the opening of new stores has driven growth by 26.6 per cent since 2015. Existing store sales in Australia and New Zealand grew by 14.8 per cent and in Europe by 8.2 per cent; however, the newly acquired Japanese division suffered a decrease of 2.1 per cent.

The 2015–16 statistics were impacted by significant one-off costs related to the acquisition of Joey's Pizza, Domino's Germany and Pizza Sprint. Growth included 182 new stores opened in existing geographic regions and 302 stores through the acquisition of these businesses. By the end of the 2016 financial year, the Domino's network included 714 stores in Australia–New Zealand, 816 in Europe and 453 in Japan.

Growth in Australia and New Zealand of 27.9 per cent in earnings resulted from initiatives such as:

- Project 3-10, involving pick-up orders ready in five minutes and delivery in under 10 minutes
- focus of product – 'More than just pizza'
- digital innovation – 'On Time Cooking'
- the 15/20 Minute Service Guarantee for faster and safer deliveries
- Domino's Robotic Unit (DRU)
- opening of 49 new stores.

In Europe, revenue increased by 52.4 per cent from 2015, which was driven by:

- the opening of 64 new organic stores, 302 acquisitions and the benefits of economies of scale
- continued online sales (especially in the Netherlands where this medium is about 70 per cent of sales)
- introduction of Domino's GPS Driver Tracker
- new digital payment methods for customers
- product innovation; for example, increased chicken and dessert ranges (especially in Germany).

In Japan, revenue rose by 27.7 per cent from 2015. Although costs for store makeovers, store relocations and redundancy payments were high, Domino's has established the foundations for future growth here.

Currently, Domino's has 87 648 158 fully paid ordinary shares held by 7353 individual shareholders. Each fully paid share carries one vote. The main three shareholders hold approximately 64 per cent of total shares issued. These shareholders are: Somad Holdings Pty Ltd, J.P. Morgan Nominees Australia Limited and HSBC Custody Nominees (Australia) Limited.

Domino's profitability is also reflected in its fully franked dividends for 2015 made up of an interim dividend of 24.6 cents per share and final dividend of 27.2 cents; and for 2016 an interim dividend of 34.7 cents per share and a final dividend of 38.8 cents (70 per cent franked) paid on 7 September 2016.

Source 15.1 Domino's logo

Source 15.2 Share price and dividends for Domino's Pizza Enterprises Limited 2012–16

	3 July 2016	28 June 2015	29 June 2014	30 June 2013	1 July 2012
Share price at start of year	$36.16	$21.82	$11.17	$10.05	$6.22
Share price at end of year	$68.82	$36.16	$21.82	$11.17	$10.05
Interim dividend per share[1]	34.7 cents	24.6 cents	17.7 cents	15.5 cents	13.0 cents
Final dividend per share[1]	38.8 cents	27.2 cents	19.0 cents	15.4 cents	14.1 cents

[1] Interim and final dividends for the year ended 3 July 2016 are franked to 70 per cent at 30 per cent corporate income tax rate and prior periods interim and final dividends were franked to 100 per cent at 30 per cent corporate income tax rate.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Source 15.3 Domino's geographical segment revenues and results

	Year ended 3 July 2016				Year ended 28 June 2015			
	Australia/ New Zealand $'000	Europe $'000	Japan $'000	Total $'000	Australia/ New Zealand $'000	Europe $'000	Japan $'000	Total $'000
Continuing operations revenue and other revenue	267 958	260 895	401 365	930 218	216 811	171 283	314 343	702 437
EBITDA[1]	91 640	28 085	47 520	167 245	71 623	18 295	37 853	127 771
Depreciation and amortisation	(13 150)	(10 259)	(14 720)	(38 129)	(11 797)	(6 939)	(8 744)	(27 480)
EBIT[2]	**78 490**	**17 826**	**32 800**	**129 116**	**59 826**	**11 356**	**29 109**	**100 291**
Interest				(3 297)				(2 451)
Net profit before tax				**125 819**				**97 840**

1 Earnings before interest, tax, depreciation and amortisation

2 Earnings before interest and tax

Objectives

Profitability

Domino's continues to drive expansion in order to generate increased long-term profitability for its shareholders (see Source 15.2).

Growth

Rapid expansion, especially over the last few years, has seen Domino's expand to over 2000 stores worldwide. The acquisition of Pizza Sprint, a chain of 89 pizza stores in France, has reinforced Domino's position as the largest pizza chain in France. Domino's also acquired Joey's Pizza's 212 stores and is the largest pizza chain in Germany. At the end of July 2016, there were 453 stores in Japan.

Efficiency

Domino's continued to work towards improved efficiency in operations such as its online ordering systems and guaranteed quick delivery of its product to its customers. Directors' performance is directly

Source 15.4 Domino's has over 2000 stores worldwide.



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

linked to the fulfilment of their financial performance objectives and to their individual share options entitlements. Domino's allows a credit period of 30 days for its accounts receivable and has a turnover rate of approximately 13 times per year.

Solvency

In 2016 there has been increased debt in the short term due to Domino's strategy for rapid growth. Domino's has achieved record increases in sales worldwide as its marketing has correctly and successfully targeted the Domino's market.

15.2 Influences on financial management

Sources of finance

Internal equity

Domino's continues to fund its operations from its working capital. Store sales, royalties and suppliers fees from its franchisees provide significant funds for the business.

As a 'going concern', Domino's also retains profits from past financial periods to be reinvested for future growth. In 2016 this accounted for $134 798 000 of total equity. It has also sold some unwanted assets.

External equity

In 2016, Domino's had an issued capital of fully paid ordinary shares valued at $248 554 000, an increase of about $50 million from 2015. Share options for directors form part of their remuneration package. In 2016, a total of 939 179 options were available for executives and formed part of the $41 433 564 of additional share capital raised. Each individual option can be converted into one ordinary share. Domino's had 87 319 000 registered ordinary shares at the end of the 2016 financial year. For the years 2006–08 Domino's shareholders were able to reinvest some or all of their dividends into additional shares; however, this has been discontinued, and for 2016 dividends can only be paid as cash. The Australian Securities Exchange valued Domino's market capitalisation on 2 October 2016 at $6 296 376 153.

Debt

Domino's accesses debt finance both domestically and internationally. Financial statements show that Domino's has debt finance from European institutions, loans from other businesses, bills of exchange and debenture (long-term debt finance), overdrafts and commercial loans (short-term debt finance).

When acquiring finance, Domino's finance manager matches the principal outstanding and the interest rate charged to the estimated future cash receipts and expected life of the asset. Domino's deals with financial institutions in the country where it is expanding and has financial arrangements with banks such as Rabobank Australia, HSBC, Westpac Banking Corporation, Sumitomo Mitsui Banking Corporation, Bank of Tokyo-Mitsubishi UFJ and Mizuho Financial Group. In terms of financial costs, the weighted average interest rate on funds borrowed was 1.47 per cent per annum for 2016 and 1.64 per cent for 2015.

Domino's also provides loan finance to its franchisees. Average interest charged in 2016 for Domino's loans to its franchisees:

- France: 5.5 per cent
- Netherlands: 7.1 per cent
- Germany: 4.3 per cent
- Japan: 5 per cent.

The entity holds the respective franchisee's store asset as collateral for these loans.

Leasing

Financial leases relate to plant and equipment with lease terms between 3 and 10 years, and motor vehicles between three and five years. Many of these leases include options to purchase the leased assets for a nominal amount at the completion of the lease

Source 15.5 Domino's other revenue

	2016 $'000	2015 $'000
Interest revenue:		
Bank deposits	362	131
Other loans and receivables	1 128	631
	1 490	762
Rental revenue:		
Store asset rental revenue	5 064	3 862
Royalties	155 554	113 123
Franchise services	46 279	34 674
Other revenue	16 129	10 878
	224 516	**163 299**

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 15.6 Plant and equipment lease terms at Domino's are for between 3 and 10 years.

arrangement. Leases for less than one year involved $3.7 million in payments, and those for one to five years $7.1 million in payments, in 2016.

Influence of government

Domino's is subject to the rules set out in the ASIC Corporations Instrument 2016/191. As of March 2016, this includes rules for rounding off to the nearest thousand dollars.

As Domino's is a parent company whose registered head office is in Australia, Domino's Pizza Enterprises Limited represents its 'consolidated group'. It is subject to the Australian company tax rate of 30 per cent.

Source 15.7 Domino's income tax expense for year reconciled to the accounting net profit

	2016 $'000	2015 $'000
Profit before tax from continuing operations	125 819	97 840
Income tax expense calculated at 30 per cent	37 746	29 352
Effect of expenses that are not deductible in determining taxable profit	1 121	56
Other assessable/(deductible) amounts	156	64
Effect of different tax rates of subsidiaries operating in other jurisdictions	2 607	1 482
Effect of tax concessions (research and development and other allowances)	(2 314)	(598)
	39 316	30 356
Adjustments recognised in the current year in relation to the deferred tax of prior years	150	(341)
Adjustments recognised in the current year in relation to the current tax of prior years	(62)	(41)
Effect of change in tax rate in other jurisdictions	(177)	(555)
Income tax expense recognised in profit or loss	**39 227**	**29 419**

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

15.3 Processes of financial management

Planning and implementing

Domino's strategic plan identifies the financial needs of the business required to achieve its goals and allocates funds through budgeting to its functional departments.

Cash flow projections are based on the financial budgets approved by the Board for the 2017 financial year, which is used as the base year. Cash flows and budgets for the next five years are based on an estimated average sales growth of 4 per cent per annum nationally. This estimate is based on forecasts of future sales growth and the ability to achieve economies of scale.

Financial risks and financial controls

Risk is assessed and controls put in place. This includes ensuring a minimum loss of stock, and therefore minimising financial loss, through a 'first in, first out' (FIFO) inventory control system. The acquisition of equipment is generally linked to a realistic determination of the economic life of the asset as between 2 and 10 years. The credit policy for the sale of goods and provision of services on credit is 30 days. No interest is charged on the outstanding balance. Domino's does not hold any collateral over its trade receivable and is therefore unsecured. Domino's believes that the concentration of credit risk is limited due to the customer base being large and unrelated. In 2016, $907 000 was written off as being uncollectable, and in 2015 the amount for this was $821 000.

Before accepting any new franchisees and business partners, Domino's assesses their credit worthiness and defines credit limits which are reviewed twice a year. Domino's may provide loans to franchisees, although it ensures there is enough collateral to cover the loan if the franchisee or business partner defaults. If the franchisee defaults, Domino's may purchase the store and operate it as a corporate store.

Monitoring and controlling

Source 15.8 Consolidated Income Statement for Domino's Pizza Enterprises Limited for the year ended 3 July 2016

	Note	2016 $'000	2015 $'000
Revenue	5	705 702	539 138
Other revenue	7	224 516	163 299
Other gains and losses	8	9 758	6 444
Food and paper expenses		(286 069)	(213 059)
Employee benefits expenses	11	(217 703)	(172 112)
Plant and equipment costs		(19 225)	(18 278)
Depreciation and amortisation expenses	11	(38 129)	(27 480)
Occupancy expenses		(36 683)	(27 252)
Finance costs	9	(3 297)	(2 451)
Marketing expenses		(48 251)	(43 733)
Royalties		(46 655)	(37 640)
Store-related expenses		(19 785)	(16 841)
Communication expenses		(15 486)	(10 927)
Acquisition and integration related costs		(12 735)	–
Other expenses		(70 139)	(41 268)
Profit before tax		**125 819**	**97 840**

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

	Note	2016 $'000	2015 $'000
Income tax expense	10	(39 227)	(29 419)
Profit for the year from continuing operations	**11**	**86 592**	**68 421**
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:			
Exchange differences arising on translation of foreign operations		61 838	926
Gain/(loss) on cash flow hedges taken to equity		(5 489)	183
Gain/(loss) on net investment hedge taken to equity		(11 575)	421
Income tax relating to components of other comprehensive income		(151)	(520)
Net other comprehensive income to be reclassified to profit or loss in subsequent periods for the period		**44 623**	**1 010**
Items not to be reclassified to profit or loss:			
Remeasurement of defined benefit obligation		(323)	104
Income tax relating to components of other comprehensive income		100	(37)
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods for the period		**(223)**	**67**
Other comprehensive income/(loss) for the year, net of tax		**44 400**	**1 077**
Total comprehensive income for the year		**130 992**	**69 498**
Profit attributable to:			
Owners of the parent		82 427	64 048
Non-controlling interests		4 165	4 373
		86 592	68 421
Total comprehensive income attributable to:			
Owners of the parent		115 517	64 843
Non-controlling interests		15 475	4 655
		130 992	**69 498**

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Source 15.9 Consolidated Balance Sheet for Domino's Pizza Enterprises Limited for the year ended 3 July 2016

	Note	2016 $'000	2015 $'000
ASSETS			
Current assets			
Cash and cash equivalents	39	60 334	43 174
Trade and other receivables	13	72 143	43 883
Other financial assets	14	13 117	6 812
Inventories	15	16 675	12 282
Current tax assets	10	592	295
Other assets	21	19 565	10 101
Total current assets		**182 426**	**116 547**
Non-current assets			
Other financial assets	14	40 400	31 265
Investment in joint ventures	16	2 405	1 626
Property, plant and equipment	18	188 050	121 612
Deferred tax assets	10	14 754	7 255
Goodwill	19	407 716	283 496
Other intangible assets	20	289 927	68 740
Other assets	21	50	59
Total non-current assets		**943 302**	**514 053**
Total assets		**1 125 728**	**630 600**
LIABILITIES			
Current liabilities			
Trade and other payables	22	150 665	108 826
Borrowings	23	36 285	1 920
Other financial liabilities	24	55 893	3 262
Current tax liabilities	10	13 133	12 765
Provisions	25	4 979	4 358
Total current liabilities		**260 955**	**131 131**
Non-current liabilities			
Borrowings	23	285 507	122 912
Other financial liabilities	24	121 018	54 048
Provisions	25	10 971	9 655
Deferred tax liabilities	10	52 731	7 798
Total non-current liabilities		**470 227**	**194 413**

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

	Note	2016 $'000	2015 $'000
Total liabilities		**731 182**	**325 544**
Net assets		**394 546**	**305 056**
EQUITY			
Capital and reserves			
Issued capital	29	248 554	198 291
Reserves	30	11 194	390
Retained earnings	31	134 798	106 375
Total equity		**394 546**	**305 056**

Source 15.10 Consolidated Statement of Cash Flows for Domino's for the year ended 3 July 2016

	Note	2016 $'000	2015 $'000
Cash flows from operating activities			
Receipts from customers		1 021 623	780 199
Payments to suppliers and employees		(857 771)	(652 481)
Interest received		1 479	756
Interest and other costs of finance paid		(3 297)	(2 452)
Income taxes paid		(33 562)	(19 984)
Net cash generated by operating activities	**39**	**128 472**	**106 038**
Cash flows from investing activities			
Payments for investments and business operations, net of cash and inventory acquired	38	(17 411)	(12 168)
Net cash outflow on investment in joint ventures		(779)	(1 626)
Loans to third parties and franchisees		4 337	(3 162)
Payment for property, plant and equipment		(86 768)	(59 686)
Proceeds from sale of businesses and other non-current assets		20 849	18 851
Payments for intangible assets		(27 106)	(14 851)
Net cash outflow on acquisition of subsidiaries	46	(157 090)	–
Net cash used in investing activities		**(263 968)**	**(72 642)**
Cash flows from financing activities			
Proceeds from borrowings		201 620	27 831
Repayment of borrowings		(27 027)	(24 831)
Dividends paid		(54 004)	(37 621)
Issue of shares to non-controlling interest		22 082	–

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

	Note	2016 $'000	2015 $'000
Proceeds from issue of equity securities		7 870	3 568
Net cash generated (used in)/from financing activities		**150 541**	**(31 053)**
Net increase in cash and cash equivalents		**15 045**	**2 343**
Cash and cash equivalents at the beginning of the year		**43 174**	**42 283**
Effects of exchange rate changes on the balance of cash held in foreign currencies		2 115	(1 452)
Cash and cash equivalents at the end of the year	**39**	**60 334**	**43 174**

Financial ratios

Liquidity

Liquidity (current ratio)

$$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

$$= \frac{182\,426\,000}{260\,955\,00}$$

= 0.7:1 (Currently Domino's has 70 cents in current assets for each $1 of current liabilities)

Networking capital = Current assets – current liabilities
= $182 426 000 – $260 955 000
= – $78 529 000

Domino's maintains additional undrawn facilities for the company to reduce its liquidity risk if needed. The current period of rapid growth has drawn funds available through the cash flow of its network and may appear here as possible future liquidity issues. However, the strategic plan is based on long-term growth and Domino's has made several provisions to deal with potential liquidity problems. The company

Source 15.11 Short-term financing facilities for Domino's 2015–16

	2016 $'000	2015 $'000
Secured bank overdraft facility, reviewed annually and payable at call:		
Amount used	–	133
Amount unused	3 354	11 793
	3 354	**11 926**
Secured commercial bill facility, reviewed annually:		
Amount used	290 333	116 931
Amount unused	103 814	71 034
	394 147	**187 965**

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

believes it can meet its current liabilities from its operating cash flows and the proceeds of maturing financial assets. Cash equivalents are short-term, highly liquid investments that are readily converted to known amounts of cash with maturity periods of no more than three months. Domino's has also arranged overdraft facilities.

It also values inventories on a FIFO basis and ensures minimum loss of stock due to the perishable nature of much of its product.

Gearing: Debit to Equity Ratio

$$= \frac{\text{Total Liabilities}}{\text{Total Equity}}$$

$$= \frac{260\,955\,000 + 470\,227\,000}{394\,546\,000}$$

$$= \frac{731\,182\,000}{394\,546\,000}$$

= 1.85:1 OR 65 per cent for 2016 (1.84 ÷ 2.84 as a percentage)

This means that 65 per cent of Domino's funding is from debt and 35 per cent is sourced from equity. This compares to approximately 27 per cent for 2015.

This increase in debt is explained by the increase in financial lease payments and the European loans for the acquisition of Pizza Sprint in France, Joey's Pizza and Domino's Germany, and pizza stores in Japan.

Profitability

Where gross profit equals revenue $930 218 000 less the cost of food and paper of $9 758 000

Gross Profit Ratio

$$= \frac{\text{Gross Profit}}{\text{Sales Revenue}}$$

$$= \frac{920\,460\,000}{930\,218\,000}$$

= 98.9%

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

$$= \frac{125\,819\,000}{(705\,703\,000 + 224\,526\,000)}$$

$$= \frac{125\,819\,000}{930\,218\,000} \times \frac{100}{1}$$

= 13.5%

$$\text{Return on Equity Ratio for 2016} = \frac{\text{Net Profit}}{\text{Total Equity}}$$

$$= \frac{125\,819\,000}{394\,546\,000}$$

= 31.9%

Efficiency

$$\text{Expense Ratio} = \frac{\text{Total Expenses}}{\text{Sales Revenue}}$$

$$= \frac{814\,157\,000}{930\,218\,000}$$

= 87.5%

Accounts Receivable Turnover Ratio

$$\text{Step one} = \frac{\text{Sales}}{\text{Accounts Receivable}}$$

$$= \frac{930\,218\,000}{72\,143\,000}$$

= 12.89 times per year

$$\text{Step two} = \frac{365 \text{ (days in a year)}}{12.89}$$

= 28.3 days on average

Comparative ratio analysis

Source 15.12 Domino's Consolidated entity's earnings 2012–16

	3 July 2016	28 June 2015	29 June 2014	30 June 2013	1 July 2012
Revenue	930 218	702 437	588 673	294 890	264 887
Net profit before tax	125 819	97 840	66 560	40 765	37 644
Net profit after tax	86 592	68 421	45 296	28 657	26 936

The data for revenue and the tax liability on net profit is compared to past financial periods, as well as to budgets and the achievement of financial performance objectives. All trends are compared to ensure Domino's strategic outcomes such as identifying savings, customer satisfaction, hygiene, training and staff development are being achieved.

Limitations of financial reports

Normalised earnings

Domino's has identified the one-off significant expense of $12.7 million for the acquisition of Joey's Pizza, Domino's Germany and Pizza Sprint as well as a one-off cost for redundancy incurred due to the relocation of Paris Commissary.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Capitalising expenses

Operating lease payments are recognised as an expense. However, financial leases may be capitalised. Also borrowing costs related to the acquisition, production or construction of qualifying assets and that take a substantial period of time to be ready for use, are added to the cost of these assets through capitalising.

Valuing assets

The directors of Domino's are required to make judgements, estimates and assumptions about the fair value of assets that are not obvious from other sources; for example, goodwill and indefinite life assets. The value of goodwill was very relevant when purchasing Joey's Pizza, Domino's Germany and Pizza Sprint. Historical costs are used to value assets in the annual report, except for some properties that have been adjusted at fair value at that point in time (that is, the current resale market value of the item).



Source 15.13 The value of goodwill is very relevant when making acquisitions.

Timing issues

Transactions are recorded as at the date of the event.

Some variation in accounting periods in overseas members of the Domino's group may necessitate adjustments to be made for the entities' financial reports. Whereas Australia and New Zealand follow the same financial year, France, Germany, the Netherlands and Belgium are based on the calendar year and Japan's tax year is from 1 April to 31 March of the following year.

Debt repayments

Domino's ensures that it pays its debts on time and if necessary seeks to extend its loan arrangements. Domino's organised additional funding through the execution of multicurrency facility agreements with multiple institutions. This included an extension to the existing secured variable rate loan with the expiry date in 2020.

Notes to the financial statements

Domino's 2016 Annual Report included 73 pages of 'notes to the financial statements'. Domino's provides information linked to the financial statements to further explain the content in each of the reports. This information provides a greater understanding of the strategies that Domino's has utilised to grow its business worldwide.

Ethical issues related to financial reports

Domino's has developed a code of conduct which sets standards for each director, executive and employee for their duties.

As outlined in its 2016 Annual Report, Domino's requires each individual to:

- act honestly, in good faith and in the best interests of the Company as a whole;
- act with high standards of personal integrity;
- comply with laws and regulations that apply to the Company and its operations;
- not knowingly participate in any illegal or unethical activity;
- not enter into any arrangement or participate in any activity that would conflict with the Company's best interests or that would be likely to negatively affect the Company's reputation;
- not take advantage of the property or information of the Company or its customers for personal gain or to cause detriment to the Company or its customers; and
- not take advantage of their position or the opportunities arising there from for personal gain.

Ernst & Young is engaged to conduct internal audit reviews to evaluate, test and report on the adequacy and effectiveness of the company's operational risks. An independent remuneration

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

consultant, Egan Associates, is engaged to ensure that reward practices are level for senior management and are consistent with market practice.

Deloitte Touche Tohmatsu Limited audits the financial report of Domino's Pizza Enterprise Limited and checks that Domino's financial statements comply with the International Financial Reporting Standards and the Australian Auditing Standards. The accounts also comply with the *Corporations Act 2001* and Australian Securities and Investments Commission (ASIC) regulations and provide a true and fair view of the financial position and performance of the firm.

15.4 Financial management strategies

Cash flow management and working capital management

Domino's provides budgets for its functional departments and carefully monitors its expenses. The organisation encourages the development of its staff and achieved significant improvements in productivity of approximately 20 per cent last financial year. Domino's is undergoing an extensive global growth strategy and has funded this expansion mainly through increased debt. Sales revenue continues to grow as increased store numbers and marketing by the group has been very successful. Domino's has organised funds available to support its cash flow through cash reserves, short-term maturing assets and overdraft facilities to ensure that the firm maintains its liquidity.

Domino's has a rigorous creditworthiness policy which is reviewed twice yearly. The group uses leasing for much of its equipment. Inventories use a FIFO system for inventory control.

Profitability management

Domino's is ethical in its procedures and pays for its acquisitions on a fair value basis. The organisation pays for the goodwill of newly acquired businesses based on an assessment by its directors. It has improved productivity of its staff and equipment through leading-edge technology and staff training. Inventory is controlled on a FIFO basis to eliminate product waste (remembering that much of Domino's inputs are perishable). Expansion through existing pizza chains has been thoroughly researched and proved successful.

Global financial management

Domino's finance department coordinates access to domestic and international financial markets, monitors and manages the financial risk relating to market risk (including currency risk, interest rate risk and price risk), credit risk and liquidity risk. This is done by using derivative financial instruments to hedge these risk exposures. Cash flow hedges are used for interest rate changes for dealings in Japan. As Domino's uses a mix of fixed and floating interest rate loans, it uses interest rate swaps based on the difference between the fixed and floating interest amounts.

Domino's enters into derivative arrangements to manage its exposure to international interest rates and foreign exchange rate risk using forward contracts and interest rate swaps. A derivative may be recognised as an asset or if it results in a negative outcome it is recognised as a financial liability.

Hedges of foreign exchange risk on business commitments – for example, in dealings with Japan – are accounted for as cash flow hedges. The gain or loss relating to ineffective hedging is recognised in profit or loss and is included in 'other gains and losses' in the income statement.

Source 15.14 Hedging reserve as a result of hedging activities in 2016

	2016 $'000	2015 $'000
Balance at beginning of financial year	4517	4094
Gain/(loss) recognised:		
Net investment hedge	(11575)	295
Cash flow hedge	(5489)	128
Income tax related to gain/loss on hedging items	3766	–
Balance at end of financial year	**(8781)**	**4517**

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Net investment hedges are used for euro loans. The strategy is to hedge the foreign currency translation risk arising on the net investment in its foreign operations. Cross-currency interest rate swaps are used to hedge the foreign currency translation risk.

Domino's conducts Australian business in Australian dollars, euros in Europe and when purchasing equipment mainly deals in forward foreign exchange contracts held in US dollars. The exchange rate exposure in this case arises from the delay between entering into the contract and the date for final payment. The majority of its international exposure is with the Japanese yen and the euro as the borrowings in these countries are denominated in their own currency.

Domino's is a successful and well-planned enterprise. It has undertaken tremendous growth over the last few years and is continuing to grow internationally. Growth is not only based on the number of outlets, but also on leading-edge technology, staff development and listening to its market to determine changes in its product. Domino's is at the forefront of modern and increasingly nutritional food services providing healthy alternatives to a more informed market that has many fast-food alternatives to choose from, and increasingly chooses Domino's worldwide.



Source 15.15 Domino's is a successful and well-planned enterprise.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Multiple-choice questions

1 In 2016, Domino's declared an after tax profit of:

A $ 92 million
B $ 29 million
C $ 125 million
D $ 52 million.

2 How many Domino's stores were opened in Australia and New Zealand in 2016?

A 29 stores
B 49 stores
C None
D 27 stores

3 How many stores did Domino's have worldwide in 2016?

A 182 stores
B 714 stores
C 453 stores
D More than 2000 stores

4 Domino's has introduced new technology to improve efficiency. One area for improvement has been through:

A relocating profitable stores
B introduction of online ordering systems
C improved liquidity
D issuing dividends to shareholders.

5 Why has Domino's liquidity ratio decreased for 2015 and 2016?

A Poor collection of accounts receivable
B Bad debts written off
C Cash flow used for business expansion
D Poor sales

Short-answer questions

1 Discuss the key financial objectives currently most relevant to Domino's.

2 Explain how the limitations to financial statements have impacted Domino's financial reports.

Extended-response question

With reference to Domino's, analyse the sources of funds that Domino's has used to finance their global expansion.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Topic 4

Human resources

25% of indicative time

Principal focus

This topic focuses on the impact human resources management has on the performance of a business.

Introduction

Human resources is the process of managing an organisation's workforce. For any business 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 organisation'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 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 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 resources 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

16 Role of human resource management

Chapter objectives

In this chapter, students will:

- investigate the strategic role of human resources
- analyse human resource management's interdependence with other key business functions
- explain and evaluate outsourcing.

Key terms

- contract for service
- contract of service
- human resources
- human resource management
- outsourcing



ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

16.1 Introduction

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:

- 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.

16.2 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.

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.



Source 16.1 Recruitment is a role of human resource management.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 16.2 Businesses use performance reviews to examine the effectiveness and efficiency of their employees.

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 16.3.

Source 16.3 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.

Activity 16.1 Comprehension

1 Describe the role of human resource management within a business.

2 Identify four characteristics 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.

16.3 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,

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

accounting, and marketing and finance must work together to win the game – that is, to ensure the success of the business (see Source 16.4).

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.



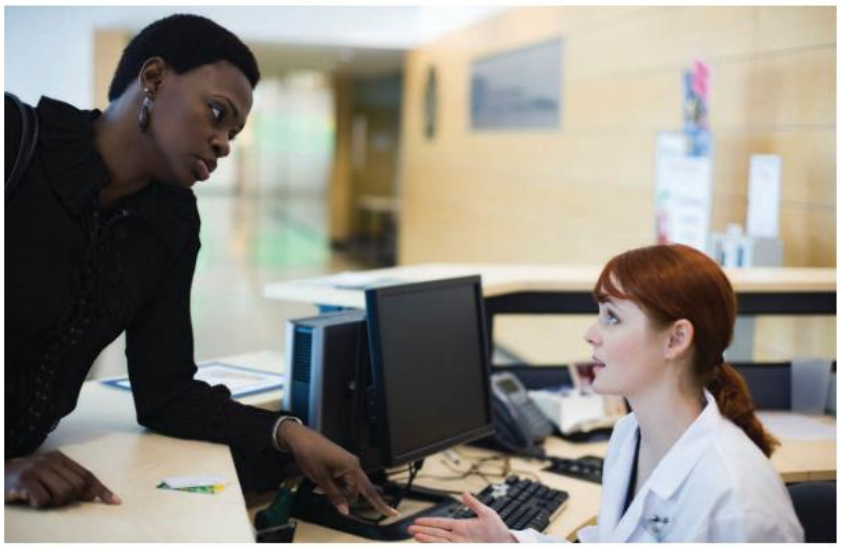
Source 16.4 The key business functions

Human resources' relationship to the operations function

The operations function is concerned with the process of production and supplying a particular good. 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 would come 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 16.5 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.

Activity 16.2 Analysis

1 You have been employed as a consultant for Redan Building Services. Explain to the head of each key business function the role of human resource management.

2 Explain how a reduced budget allocation on training and development may adversely affect the business.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

16.4 Outsourcing

Outsourcing Occurs when a business takes a part of a key function and gives it to another company to perform.

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 function, rather than maintaining an in-house human resources team.

- Outsourcing provides the ability to access staff whose speciality is human resource management. These staff would have a much better understanding of issues related to employment relations and can advise the business on the most appropriate human resource strategies.
- 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.

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 has 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 to be 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

Business Bite

In 2007 Telstra sought to enhance the learning of its frontline staff; that is, those employees who are the face of the business, and deal with customers on a daily basis. It called on the services of Australian-based Accenture to develop a training program as part of this transformation. As a result, the Telstra Learning Academy was established to develop the skills and knowledge of its people. Accenture works closely with Telstra in delivering training programs to its employees to better sell the telecommunications giant's products and meet the needs of its customers.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 to 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 16.6.

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 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.

Source 16.6 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

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 16.1

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?

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 16.7 Jetstar hires cabin crew from foreign companies.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 include:

- the ability to access staff whose speciality is human resource management
- allowing managers of the business to focus on the core business operations
- the decision of a business to outsource its human resource function to generate cost savings.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Issues concerned with outsourcing the human resources 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 resource management and each of the other key business functions: marketing, finance and operations.

Multiple-choice questions

1 Which of the following best describes the role of human resource management within a business?

- **A** The management of financial resources
- **B** The relationship between a business and its suppliers
- **C** The development of a marketing plan
- **D** The management of 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 is a benefit of developing a strategic approach to human resources?

- **A** The development of a highly qualified workforce that fosters skill development and employee recognition
- **B** Increased employee motivation through greater incentives in the workplace
- **C** Decreased cost savings due to the need for greater management supervision of employees
- **D** A workforce that loses focus as being the competitive advantage that the business has over its competitors

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 statements best describes a benefit to the business of outsourcing the human resource function?

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Explain three issues a business must examine when considering 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 its interdependence with other key business functions.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

17 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

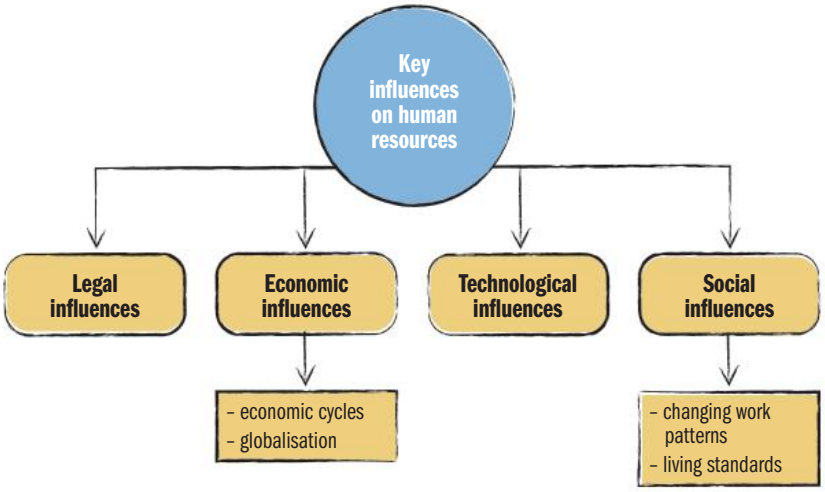
17.1 Introduction

The employment relationship extends beyond that of the employer and the employee. The nature of employment relations in Australia means that a number of other stakeholders are also involved (Source 17.1). Each stakeholder seeks to protect and promote their own interests.

In addition, there are four key influences on human resources (Source 17.2).



Source 17.1 The six stakeholders in the employment relations process



Source 17.2 The four key influences on human resources

17.2 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 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. These managers are known as directors 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 500 000 Australians each year.

Employer An individual or organisation that pays others to work for its business.



Source 17.3 The financial services industry in Australia is a major employer.

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

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.

Legislation Laws made by parliament.

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.



Source 17.4 Childcare provisions help employees with young families.

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 childcare, 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. A new innovation is to allow various staff members to work from home if they wish, and it is practicable for the business for them to do so. Advances in technology through the internet and smartphones have facilitated this development. See the example provided of the staff benefits offered by Westpac.

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.

Ethical spotlight 17.1

Employees receive an income for their work. As a result, it's expected that they will follow the instructions of their employer. Conflict, then, should not occur in the workplace. Do you agree with this view?

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Westpac employee benefits

Borrowing
Receive discounted interest on personal & home loans, as well as establishment, application & monthly fee waivers

Car parking
Salary sacrificed car parking

Career Break
Up to 12 months unpaid leave to support employees pursue their personal development

Computers
Competitive pricing on a range of computer products, including a salary sacrifice option on laptops

Counselling
Westpac offers employees assistance when experiencing personal or work related problems through ACCESS; a confidential, professional guidance and counselling support service

Credit Cards
Discounted customer rate on most Westpac credit cards and the first year's annual fee waived across most Westpac card products

Electrical Appliances
Our supplier will try & source a better deal for you on Electronic Appliances, including Televisions and Office Equipment

Employee Shares
If Westpac achieves its targeted performance each year, all permanent employees are entitled up to $1,000 worth of shares, at no cost (subject to conditions)

Flexible work practices
Westpac encourages flexible work practices and invests in telecommuting and other initiatives such as job sharing

Health care
Discounted health insurance, plus discounts on health programme products

Investment
Rebates on application fees for BT Investment Funds & BT Lifetime Super and a discount with BT Margin Lending. You can speak to a Financial Planner for free and receive a discount off your plan preparation charges.

Insurance
As an employee you will get a discount on annual premiums for Life Insurance, General Insurance and Motor Vehicle Insurance

Motor Vehicles
Benefit on discounted motor vehicles through a number of relationships Westpac has with various car makers. Novated Leasing is available to eligible employees.

Parental leave & childcare
As an employee, you are entitled to 12 weeks paid parental leave and 104 weeks parental leave, as well as affordable, pre-tax, care through Westpac owned corporate child care centres

Professional memberships
Westpac will cover the cost of entry fees and annual subscriptions for one approved professional organisation and/or cover partial costs to annual subscriptions

Public transport
Westpac offers an interest free loan for the purchase of public transport to assist employees with the cost of travelling to and from work

Savings & transaction accounts
Pay no bank service fees on your transaction accounts & receive bonus interest on Term Deposits

Social Clubs
Westpac has Social Clubs in every state giving you discounts on movie tickets, sunglasses, fragrances, gym memberships, theatre tickets and a range of other great deals. We also have many exclusive Westpac discounts with retail and service providers.

Study assistance
If you are studying, eligible employees will be reimbursed 100% of their compulsory course fees/Higher Education Loan Programme (HELP)

Telecommunications
Cheap rates on your mobile, internet and other related products & services

Travel
Discounts on accommodation across Australia and car hire and free travel consulting

Travellers Cheques & foreign bank notes
Fee free travellers' cheques and foreign banknotes

Westpac book club
You will be able to get great deals on books through the Westpac Book Club

Source: Westpac, 'Westpac employee benefits'.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 17.5 The NSW Nurses and Midwives' Association is an example of a union.

Shop steward A union's representative in the workplace.

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.

In early 2011, approximately 20 per cent of Australian employees were trade union members. Union membership has been in steady decline since the mid-1980s.

According to the ACTU, there are several reasons for this decline:

- With a move towards private-sector organisations providing services on behalf of the government, fewer people are now employed directly by government agencies and departments. The public sector has traditionally been a strong area of union representation.
- 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.

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 17.6 Government organisations in the employment relationship

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 17.7 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. They are also known as enterprise agreements. 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.

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 which 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), 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 his or her dismissal was 'harsh, unjust or unreasonable'
- apply the Better Off Overall Test to certain wage agreements.

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.

Award A legal document that specifies the minimum working conditions that apply to all people employed in a common industry.

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 Is used when the Fair Work Commission offers suggestions to help resolve an industrial dispute. These recommendations are not legally binding.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 Human Rights and Equal Opportunity Commission was established in 1996 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

Data has shown that three in four employers had not performed a gender pay gap analysis, and that gendered pay gaps began to close in companies where the CEO had a daughter. The Workplace Gender Equality Agency (WGEA) undertook a campaign in 2014 called 'Daughter Water', where a bottle of water was sent to 3000 CEOs who had reported that they had not undertaken a gender pay gap analysis. This Daughter Water claimed to 'help' the CEO conceive a daughter, in the hope that the trend of parenting a daughter would continue and effect positive change to wage equality in their organisation. This campaign was designed to raise awareness within leadership positions of the gender pay gap.

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 are reflective of behaviours that are upheld within society. Issues such as perceived discrimination, harassment and unfair working conditions are becoming increasingly publicised. With strong media attention, businesses must be seen to respond in a manner that is consistent with the view of society. For example, should employees be available outside of work hours to respond to work-related emails and phone calls?



Source 17.8 Workplace practices are reflective of society's values.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

In February 2016, Filipino boxing champion Manny Pacquiao made inflammatory and degrading comments about same-sex relationships. As a result, popular sporting brand Nike removed its sponsorship of Pacquiao and severed all ties with the boxer.

Activity 17.1 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.

17.3 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 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.

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 has meant that the traditional definition of an employee has changed. As discussed in Chapter 16, 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 strategies, for example. The law regards an employee to be 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 17.9 Employment contracts create rights and responsibilities for employers and employees.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 17.10.

Source 17.10 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).

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



Source 17.11 Employees have a duty to report any pre-existing injuries to their employer.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Regulating the relationship between employers and employees

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. They 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.

What is the current national minimum wage?

The current federal minimum wage (before tax) is $17.70 per hour or $672.60 for a 38-hour week. The national minimum wage can also cover casual employees, who get at least a 21 per cent loading.



Source 17.12 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Minimum 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 parents or carers of a child under school age or of a child under 18 with a disability, to request a change in working arrangements to assist with the child's care.
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 and compassionate leave:** 10 days paid personal/carer's leave, two days unpaid carer's leave as required, and two days compassionate leave (unpaid for casuals) as required.
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 1/1/10 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, 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 17.2
Role-play

Spiros has been asked by his employer, Gramsec Securities, to consider signing a new individual workplace contract. As his union adviser, explain to Spiros what an Australian workplace 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 employees are entitled to a minimum of four weeks of holidays per year and receive 1.1 weeks of long service leave for each year of service to the business.



Source 17.13 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 to 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.

Activity 17.3
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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 17.14 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 Human Rights and Equal Opportunity Commission enforces anti-discrimination legislation. While 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 Human Rights and Equal Opportunity Commission.

Business Bite

The *Age Discrimination Act 2004* (Cth) helps to ensure that people are not treated unfavourably due to their age. Stereotypes about both young and older Australians are a major factor behind age discrimination. The Act allows Australians to voice complaints to the Human Rights and Equal Opportunity Commission if they feel they have been wronged in various areas of public life, including employment.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

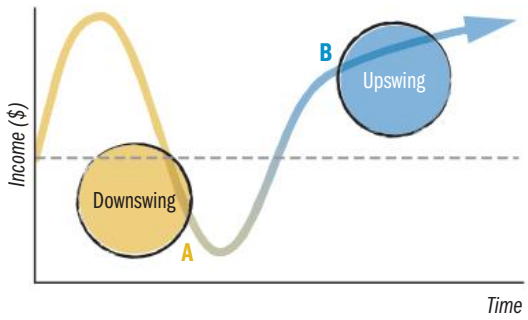
Activity 17.4 Summarise

Construct a summary table outlining the differences between federal and state government workplace legislation.

17.4 Economic

The economic cycle

The significance of a business to an economy cannot be understated. As petrol is to a car, 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 in an economy 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, 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.



Source 17.15 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.

This increased spending encourages business to demand more labour as a means of producing more goods and services. The main reason why more goods and services are often produced is because 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.

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.

Globalisation

Globalisation refers to the integration of the world's economies into a single market where goods and services can be traded with ease. 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. Over the past 20 years, Australian businesses have faced



Source 17.16 Globalisation has led to the closure of local businesses.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

increased competition from foreign 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. 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.

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.

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 $3000 and $5000. Leading gobal 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.

Activity 17.5 Discussion

Refer to the graph in Source 17.15. 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 17.2

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. Do you agree with this view?



Source 17.17 Technology has had both positive and negative consequences on human resources.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

17.5 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 feel 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 the Australian manufacturing sector causes concern. Recent data compiled by the Australian Bureau of Statistics show that employment in the manufacturing industry is in decline. The growth of technology across these industries has no doubt facilitated the downward trend.

17.6 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 often get 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 17.18 Women are underrepresented in positions of power and influence in Australia.

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.

17.7 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

Woolworths has recognised the environmental concerns of consumers regarding plastic bags, and has created an alternative: the 'greenbag'. Its staff receive training on how to 'fill the bag and not the environment'.

Energy company AGL has a community investment program called 'energy for life': in winter, homeless

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

shelters in New South Wales, Victoria and South Australia have their energy bills paid.

Ronald McDonald House Charities focuses on providing facilities and support for seriously ill children, to help them have a 'brighter, happier and healthier' life.

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 Centre 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 17.19 Switching to more environmentally friendly practices is an act of corporate social responsibility.

Business Bite

Fortescue Metals, an iron ore company in Western Australia, has an Indigenous Cadetship Support program to improve the employment prospects of young Indigenous people – especially in the Pilbara region, where the business's operations have a significant impact.

Activity 17.6 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 a bargaining agent 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
- Human Rights and Equal Opportunity 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 growth 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

Create a report for a business that identifies the key stakeholders involved in its operations. For each stakeholder, outline the role and identify how the stakeholder impacts upon the operations of the business. Make reference to how specific influences in human resource management affect each of the stakeholders.

Multiple-choice questions

1 Changes in work patterns and population trends are reflective of which influence on employment relations?

A Social
B Economic
C Legal
D New organisational behavioural

2 The growth in part-time work in recent years has been accompanied by which other feature?

A An increase in outsourcing and contract labour
B Higher levels of labour mobility
C An ongoing decline in unskilled jobs
D An increasing number of women in the workforce

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

5 Which of the following is an impact of globalisation 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 stakeholder has the responsibility of providing a workplace that is safe and healthy for all parties?

A Employees
B Employers
C Unions
D Employer associations

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 Describe how changes in a country's economic conditions can impact on the employment relationship in that country.

2 List and describe three pieces of government legislation aimed at promoting a workforce that is more tolerant of differences.

Extended-response question

Analyse the extent to which social and economic influences impact on the employment relationship.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

18 Processes of human resource management

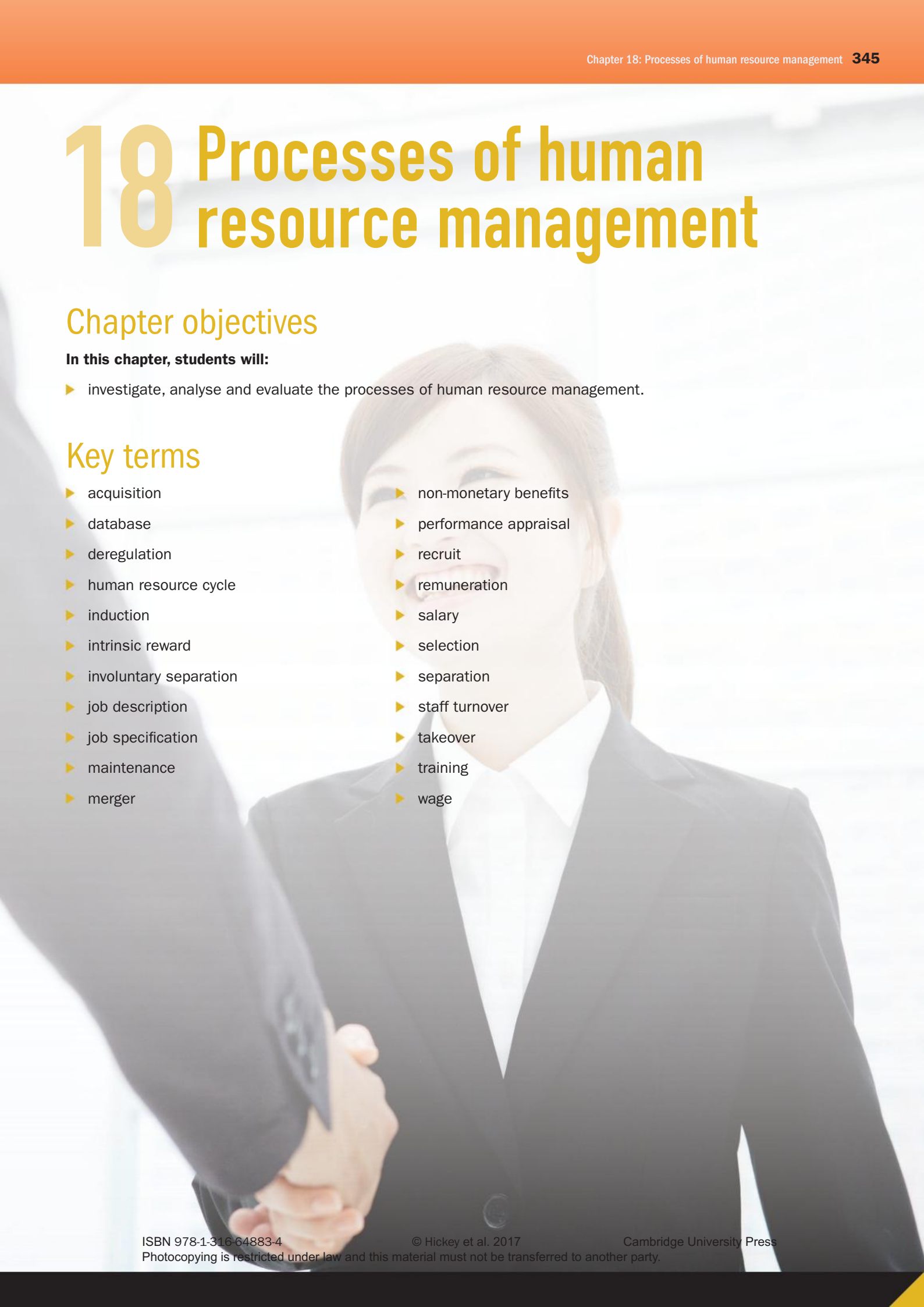
Chapter objectives

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
- job description
- job specification
- maintenance
- merger
- non-monetary benefits
- performance appraisal
- recruit
- remuneration
- salary
- selection
- separation
- staff turnover
- takeover
- training
- wage



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

18.1 Introduction

As technology, machinery and raw materials are available to businesses worldwide, the staff of a business have become a valuable asset. 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 called personnel, staffing or 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.

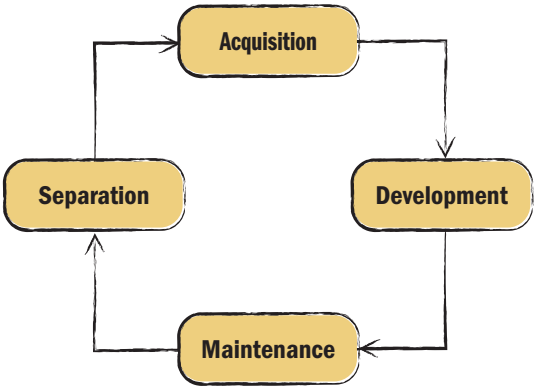
Today, however, the value of a high-quality HRM system is seen as a major component of a business's success. As a response to the growing importance placed on the human factor, the federal and state governments have passed many laws covering employment relations issues, including equal employment opportunity, anti-discrimination and occupational health and safety. Businesses must comply with these laws.

18.2 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.

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.



Source 18.1 The human resource cycle

18.3 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Acquisition is the stage in the human resource cycle that involves:

- identifying staffing needs
- recruitment
- 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 fully utilised. 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. After this, a **job specification** is developed. It outlines the key skills, experience and qualifications needed for this particular job. 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 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 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.



Source 18.2 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 3 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.

Acquisition The stage in the human resource cycle that involves staffing needs, recruitment and selection.

Job description Written statement describing the duties, tasks and responsibilities associated with a particular job.

Job specification Written statement describing the key skills, experience and qualifications needed for a particular job.

Remuneration How much a job is worth; that is, the pay and entitlements to be provided to the person employed to do the job.

Ethical spotlight 18.1

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Recruitment

Recruit To accumulate a pool of potential candidates for a job. It is from this pool that the business must make its selection.

The business can fill a vacancy by **recruiting** applicants:

- internally – from existing staff
- externally – from outside the business.

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.
- 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 résumé 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.



Source 18.3 Businesses may look within the business to fill positions.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

H

Source 18.4 Job vacancies can be advertised through employment agencies.

Business Bite

Ahmed Fahour is one of Australia's leading business people. He resigned from his role as chief executive officer of Australia Post in February 2017, soon after his controversial $5.6 million salary package was publicly disclosed. Fahour previously worked for the National Australia Bank. To encourage Fahour to join the NAB and leave his then employer, Citibank, NAB paid Mr Fahour $3.9 million for simply agreeing to work for the bank.

Activity 18.1 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Selection

Selection A screening process in staff acquisition. The information gathered about job applicants is reviewed and the most appropriate applicant is chosen.

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.

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 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.



Source 18.5 Applicants may be put through several stages in the selection process.

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. This is known as a probation period. The selection process is also applied to part-time, casual or contract workers.

Induction and orientation

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 18.6 New employees need to learn about the business.



Source 18.7 A bartender acting as a cashier is an example of development.

Activity 18.2 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.

18.4 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 club's bar steward also acting as a cashier.

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.

Training Any activities that are aimed at improving an employee's present and future performance in the workforce.

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Performance appraisals can also be carried out. This requires a formal assessment of how well 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 the Institute of Chartered Accountants, members must complete 40 hours of professional development annually.

Optus Learning and Development

Optus strongly believes in developing and rewarding our existing employees. If you join our team, we will support you to explore your potential. We offer many opportunities, activities and programs that can help you grow your career and reach your goals, whatever they may be.

Underpinned by our internal development philosophy that supports a holistic approach to learning and development, we offer you flexibility and choice to manage your career. Examples of the variety of learning and development resources we offer are:

- Support with your career through providing a range of resources and training on career planning and development.
- Access to diverse internal and external training courses on a range of topics, from technical skills to personal development topics like coaching and negotiation. We also support memberships of professional bodies and have an educational assistance policy for those pursuing relevant tertiary education.
- A mentoring program where people who want to learn and grow are paired with people who have the right knowledge and skills to share.
- Optus' structured Talent Management program ensures high performers grow within the company and reach their full potential.
- Leadership Development in Optus consists of a core program for leaders, as well as a range of diverse development opportunities in line with individual needs and interests.
- A structured induction process to set you up for success in your new role.
- The Optus Engineering Cadet Program is a combination of on-the-job learning and TAFE studies for a three-year period. It provides education in leading telecommunications technologies, along with on-the-job experience and employment.
- The Graduate Development Program is designed to provide new university graduates with an in-depth knowledge of Optus and the broader industry, whilst expanding professional and leadership capabilities.

Source: Optus.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

18.5 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
- as bonuses – these are often paid at Christmas time or at the end of the financial year as an additional reward, above a wage or salary, for hard work
- 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.

Database 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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.



Source 18.8 Intrinsic rewards can include the satisfaction of a job well done.

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 2017 it was 9.5 per cent, but by 2025 it will be 12 per cent. Superannuation is a form of fixed savings for employees' retirement.

Business Bite

A study published by the *British Journal of Social Psychology* covered research into what motivates highly skilled people to exert more effort at work. Over a period of 10 months, 1400 employees, in fields such as banking, consulting, auditing and energy, were surveyed. The researchers discovered that monetary benefits and other extrinsic motivators did not lead to an increase in effort. However, intrinsic motivation was enormously successful.

The researchers noted that most workplaces use 'internal competition, monitoring and control, and excessive use of performance-based pay systems' to motivate staff. But where the work required greater cognitive effort, these systems were not effective in motivating employees to perform at peak levels.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

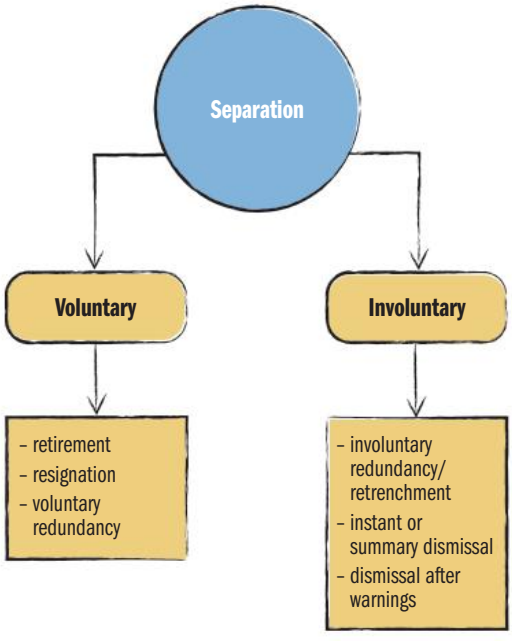
Activity 18.3 Analysis

'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.

18.6 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 his or her own free will. It may also be involuntary, when an individual member of staff is asked to leave.



Source 18.9 Separation can be voluntary or involuntary.

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. More recently, the trend has been to retire earlier, in a person's mid to late 50s, thereby taking advantage of superannuation and possibly accumulated long service leave. Many professional people (such as lawyers, doctors and accountants) continue to work into their 70s. 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.

Separation The ending of an employment contract. Separation may come from either the employee or the employer.

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 18.10 In the case of resignation, employees are required to give notice.

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.

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.

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.

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.

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 at the New South Wales Government Office of Industrial Relations website.

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.

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 18.11 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Business Bite

In June 2016, utility provider Western Power announced that 326 staff had volunteered for redundancy following a slowing economy, the rise of solar power and a reduced workload. The employees, sourced mainly from network planning and project management offices, were offered a comfortable redundancy package.

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.



Source 18.12 Dismissal may occur after a series of warnings.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

Copy and rewrite the following sentences. Use 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 resources 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_____.
- Discrimination is the u_____ treatment of a person, racial group or minority group and is based on p_____.
- EEO stands for E_____ E_____ O_____.

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 What will the level of the superannuation guarantee levy be in 2025?

A 9 per cent
B 10 per cent
C 11 per cent
D 12 per cent

3 What is the main objective of recruitment?

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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

4 Which of the following would best describe the aim of training the staff of a business?

A Selecting the most appropriate candidate
B Improving an employee's ability to do one job
C Improving an employer's ability to perform in future jobs
D Improving an employee's ability for present and future performance

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 is the document that sets out minimum wage rates and minimum working conditions for a specific occupation?

A Reward
B Award
C Occupation table
D Employment award

7 To which body in Australia is personal income tax paid?

A New South Wales government
B Industrial Relations Commission
C Australian Taxation Office
D Australian Securities and Investments Commission

8 What are the stages in the human resource cycle?

A Training, development, maintenance and selection
B Separation, maintenance, training and development
C Acquisition, selection, recruitment and separation
D Acquisition, development, maintenance and separation

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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 resources cycle. Outline the rights and responsibilities that should be taken into account.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

19 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

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

19.1 Introduction

It is widely acknowledged that a fundamental aspect of any successful business is the role of employees. Management are increasingly recognising the value of an effective human resources 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.

19.2 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.

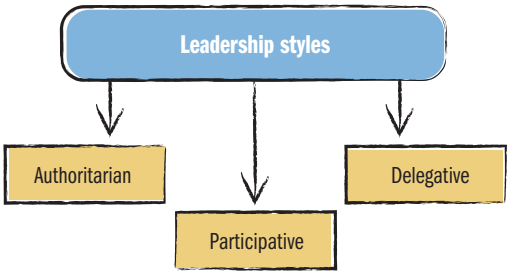
Leadership style is the manner and approach in which leaders of a business interact with staff. This interaction is based on:

- providing staff with directions and instructions
- implementing plans and organising staff
- motivating staff in a manner that promotes effective workplace performance.

It is crucial that the manner and approach leaders adopt towards employees inspire a positive culture within the business.

Types of leadership styles

Respected business theorist Kurt Lewin identified three different styles of leadership (see Source 19.1). Each form of leadership offers managers alternatives to the process of interacting with staff.



Source 19.1 Three leadership styles

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.

When is it used?

- When decisions must be made quickly.
- When management have resolved the issue and have the information to solve the problem.
- With employees who are learning a new job and requiring supervision and instruction.



Source 19.2 An authoritarian leadership style is used when an employee needs supervision and instruction.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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 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.

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.



Source 19.3 A participative workplace is one in which the manager encourages employee empowerment.



Source 19.4 Delegative leadership assumes that employees are able to represent the business and make decisions with a measure of independence.

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.

Activity 19.1 Analysis

For each of the following scenarios, propose an appropriate leadership style and list two reasons for your suggestions:

1. Nisreen leads a group of seven employees, mostly new university graduates. She has a stable relationship with her staff and feels that they can work unsupervised. Nisreen does feel, however, that final decisions must be checked by her before they are implemented.
2. Mauve manages a small business that is going through considerable change.
3. Hwan leads a team of responsible and able employees who are aware of what areas of the business they can make decisions about.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

19.3 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.



Source 19.5 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 skillsets and levels of experience.

However, this does mean that employees may be performing the same, repetitive tasks all day. An

Source 19.6 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 to complete the task?	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 to complete the task?	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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 then it may be appropriate to design a job around specific tasks.

Activity 19.2 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.

19.4 Recruitment

Recruitment is a fundamental aspect of human resource management. It is the strategy whereby management seek 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.

Activity 19.3 Comprehension

Management of a business has recently appointed an external candidate for a senior position in the firm. This has caused considerable resentment among existing internal staff who applied for the position. Advise management about the benefits of recruiting external candidates and examine possible reasons why external recruitment may cause further problems within an organisation.

Source 19.7 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 19.8 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 19.4 Research

Go to a job search website, such as seek.com, and look at the position descriptions for three different jobs. Sort the list of requirements into general and specific skills.

19.5 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.



Source 19.9 A mentor training a younger employee

Current or future skills

A business must assess if the skill sets of its staff are appropriate for its short- 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.

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.

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.

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-

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Business Bite

National Australia Bank employees undertake a number of training courses in their first 12 weeks of employment in order to ensure they are job-ready. These include an enterprise induction, Job Ready learning and other compliance training. These programs greatly benefit new employees, who are able to learn while on the job over their first three months of employment.

Activity 19.5 Analysis

For each of the benefits described below, identify whether it is provided by training and development or by induction:

- improves employees' skills
- encourages an improved awareness of the organisation's practices
- provides the business with the human skills to move into new markets
- helps employees to seek promotional opportunities with their current employer or a different organisation
- makes employees aware of dispute resolution procedures
- provides new employees with mentoring from other employees in the organisation
- allows the business to constantly improve its operations.

19.6 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

- The employee has a clear understanding of what needs to be done to be successful on 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.

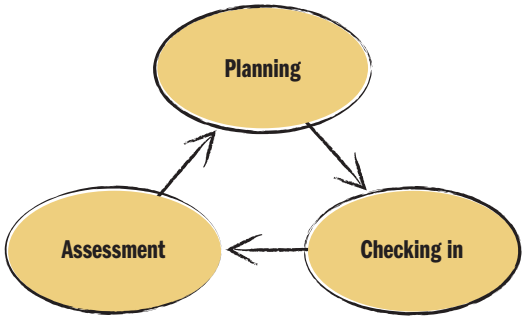
Performance management can also support administrative functions:

- 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.

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.



Source 19.10 The performance management cycle

Stage one: planning

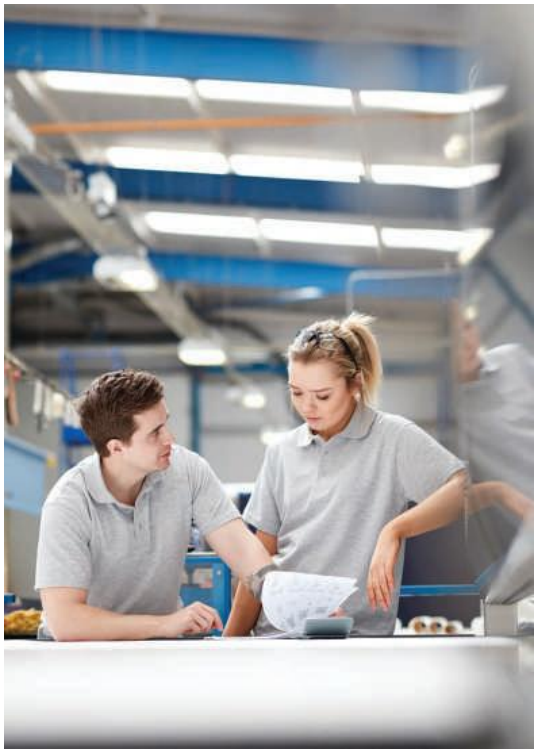
This is the first stage of the performance management cycle and it is focused on goal-setting:

- 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.

Stage two: checking in

Once the performance objectives have been established, an employer should regularly observe an employee's performance to provide feedback. Management have 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.



Source 19.11 An employer should regularly observe an employee's performance to provide feedback.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

Activity 19.6 Comprehension

1 Identify the three stages of the performance management cycle.

2 Briefly discuss why this structure is ongoing.

19.7 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 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 would be 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.

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

Business Bite

The Commonwealth Bank is one of many Australian companies that have successfully adopted an Employee Share Acquisition Plan (ESAP) as a key strategy in their provision of monetary rewards to their employees. Shares up to the value of $1000 will be distributed by the bank to its employees subject to a performance target being met.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 19.12 Group work can create a sense of teamwork in a workplace.

- 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.



Source 19.13 Difficult customers may affect performance pay.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

19.8 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.

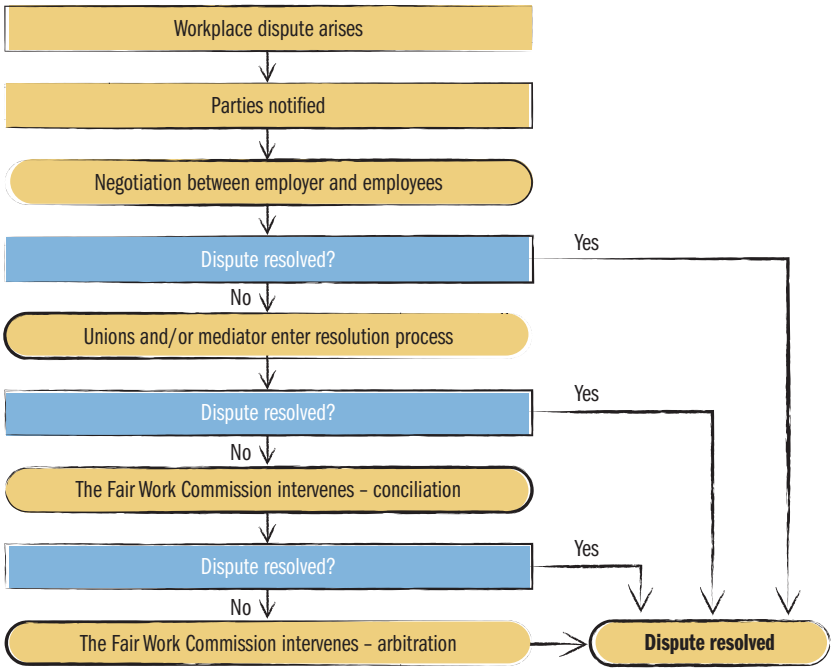
A global business will have to balance the opportunity to reduce costs by accessing cheap labour against the cost of training labour with the skills required by the business. The ability of labour to learn new skills will depend on the country's education system. Some governments are investing a significant 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.

19.9 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 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.



Source 19.14 The dispute resolution process

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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:

- 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.

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 resources 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

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**.

Grievance A dispute between parties.

Grievance procedures The rules and procedures that employees, unions and employers must follow in order to resolve a dispute.

Mediation Occurs where an independent party with no ties to either stakeholder is asked to assist the conflicting stakeholders to reach a settlement.



Source 19.15 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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 19.16 Each party has a legal obligation to attend conciliatory meetings, when requested by the Fair Work Commission.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 seek 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 the global business's decision about where to locate. It may wish to take advantage of cheap labour offered in developing countries.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Chapter revision task

Create a mind map that outlines the main features of each leadership style used by businesses. Write a report to employees outlining the benefits of performance management structures. In this report, explain the processes involved in grievance procedures for disputes between employees and employers.

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 best describes the concept of job enrichment?

A Staff are moved from one task to another in order to increase variety and interest.
B Staff are paid increased amounts of money for completing their required task.
C A program through which management encourage 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 have 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 What benefits do training and development offer a business?

A They provide employees with new skills.
B They encourage employees to seek promotions.
C They allow the business to diversify into new operations.
D They give the business a better skilled and more efficient workforce.

5 A manager and an employee are in the process of establishing goals for a new task. Which of the following stages of the performance management cycle is described here?

A Planning
B Checking in
C Assessment
D Goal-setting

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

6 Which of the following is a benefit of performance pay?

A The performance of employees may be difficult to measure.
B Possibility of conflict may emerge due to the process of measuring performance.
C Some employees may simply seek non-monetary rewards as their form of recognition.
D It encourages unmotivated and inefficient individuals to improve their performance.

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 In the process of arbitration, the decision of the Fair Work Commission is binding. What does this mean?

A All parties must accept and follow the decision.
B Employers have the right to appeal the decision.
C The decision only serves as a guide in resolving the dispute.
D Employees are expected to abide by the ruling.

Short-answer questions

1 Outline the benefits to a business that has a grievance procedure.

2 Explain how leadership styles impact upon employee performance.

Extended-response question

Evaluate the role of rewards and training and development in effective performance management.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

20 Effectiveness of human resource management

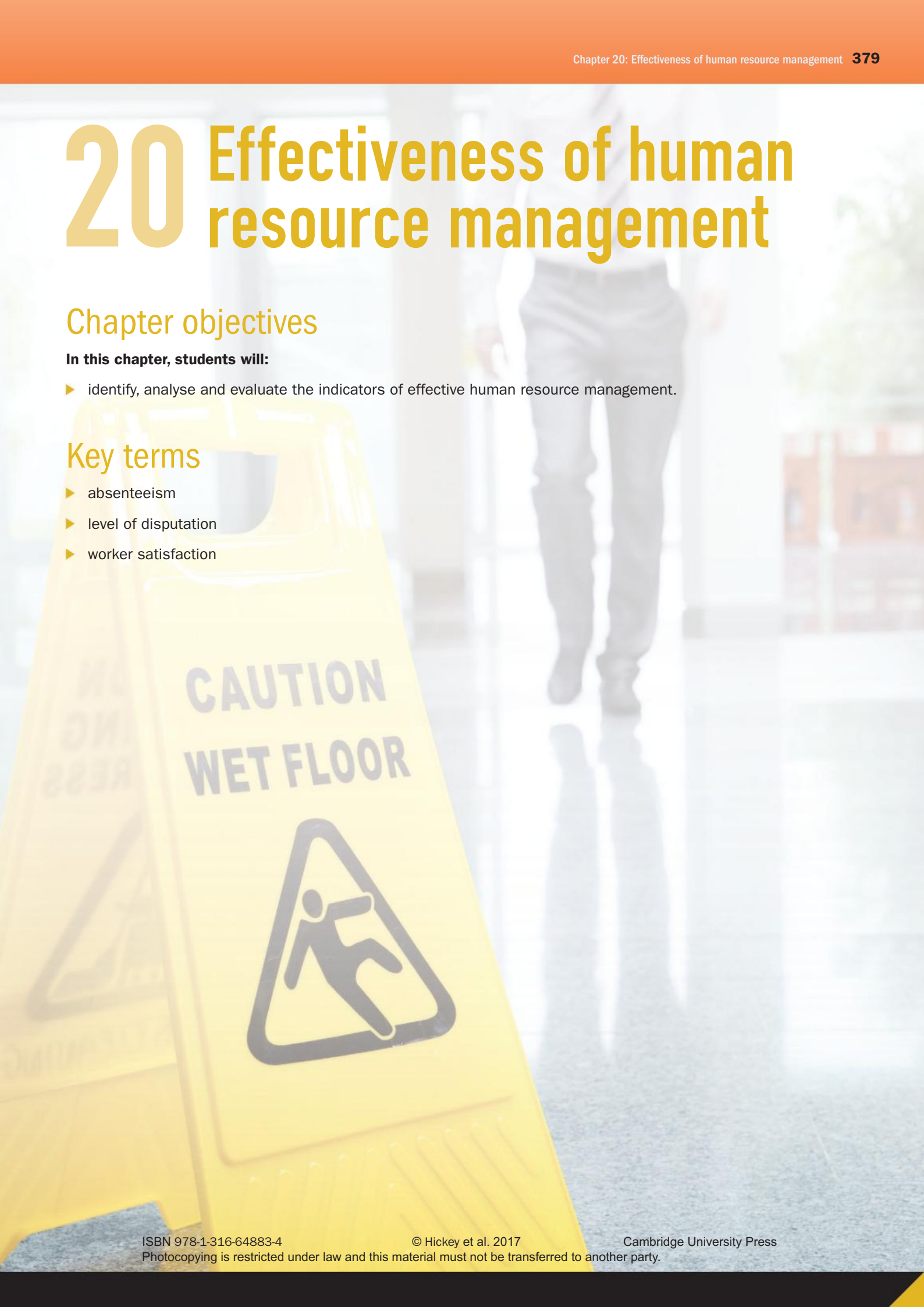
Chapter objectives

In this chapter, students will:

- identify, analyse and evaluate the indicators of effective human resource management.

Key terms

- absenteeism
- level of disputation
- worker satisfaction



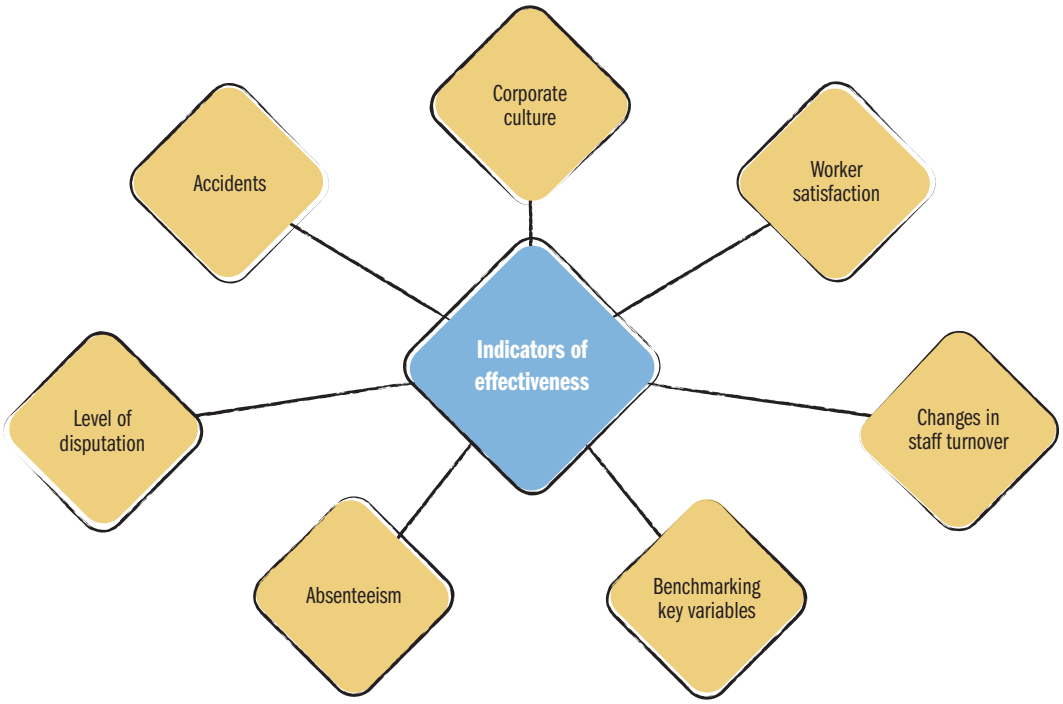
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

20.1 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. Also, the needs and interests of employees, as well as those of the business, are considered. The effectiveness of the employment relationship can be measured from a number of 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. 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.



Source 20.1 Indicators of the effectiveness of the employment relationship

Business Bite

Some of Apple's success has been credited to its corporate culture, with five characteristics being particularly identified.

1. **Excellence: a policy of selecting only top-quality workers.**
2. **Creativity: employees are expected to be highly creative in their approaches, particularly in product design and development.**
3. **Innovation: all employees are encouraged to be innovative, both in their own work processes and in contributing ideas to the company.**
4. **Secrecy: Apple works hard to prevent the theft of proprietary information and intellectual property, and upon joining the company all employees must agree to this policy of secrecy.**
5. **Combativeness: traditionally Apple had a highly combative workplace – company co-founder Steve Jobs was known for randomly asking employees to explain how they brought value to the company, and firing them if the answer was unsatisfactory. And although the culture is now becoming more relaxed, an element of combativeness remains.**

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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. 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 18, 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.

Absenteeism

Absenteeism refers to employees not attending work, usually for reasons such as illness or family responsibilities. In Australia most employees receive full pay for up to 10 sick days per year. While most employees take 'sick days' for medical or family reasons, others may use them to express their dissatisfaction with the workplace. Employees may choose not to attend work on days when various events (such as meetings and training and development programs) are being held. Absenteeism is costly, as it means that an employee's work is not done. This places additional demands on existing

Absenteeism Employees not attending work, usually for reasons such as illness or family responsibilities.

Absenteeism – some key facts

- The median was 8.0 days per employee per annum.
- Manual workers took 9.2 days compared to 7.8 for non-manual workers.
- 71% of organisations consider absenteeism to be a significant cost to their business.
- Illness (e.g. cold/flu, headaches, gastro and mental health) and home and family responsibilities are primary reasons for absenteeism.
- Over 50% of respondents consider one day absences to be most problematic to manage.
- 18% of respondents believed there was an increase in employees going to work unwell (we call it a Wickie – a working sickie). This was twice as likely to occur in the public sector compared to the private sector.
- 44% of respondents reported that the incidence of stress/anxiety/depression related absence increased in the last twelve months. 64% of public sector organisations reported an increase.

Source: Direct Health Solutions, '2013 Absence Management Survey Summary'.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

Level of disputation The number of times each year issues arise between an employer and its employees.

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 resources function.



Source 20.2 Workplace disputes decrease management effectiveness.

The more disputes there are in a workplace, the less effective management is being in managing the human resources function. Employers would need to examine why the disputes are occurring and rectify the practices that cause disputes.

Accidents

It is inevitable that, within any organisation, human error may occur. Regrettably, this error may result in concerns relating to work 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 damage and death. Each year, more than 100 000 workplace injuries are reported to WorkCover NSW.



Source 20.3 Management must implement strategies to reduce or eliminate hazards.

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.

Worker satisfaction

Worker satisfaction The level of satisfaction demonstrated by employees towards their employer and the nature of the job tasks.

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Activity 20.1 Cloze

Rewrite the following passage, using the words listed below to fill in the blanks.

- seven
- management
- work
- leave
- unhappy
- employees
- measuring
- frequency
- motivation
- standards
- best
- against
- dissatisfaction

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 employment relations function. Quality refers to the extent to which employees are working to the _____ of their ability. It includes their attitudes and _____ and 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.



Source 20.4 Worker satisfaction means that employees are contented at work.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 are 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 employment relations 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 characterised by low levels of staff turnover would also have which other features of the employment relationship?

- **A** High levels of employee satisfaction and low productivity
- **B** Regular industrial disputes and poor worker morale
- **C** High levels of productivity and good worker morale
- **D** Low levels of employee satisfaction and irregular industrial disputes

2 Which of the following could cause high staff turnover?

- **A** Employees moving to other positions in the organisation
- **B** Effective induction and training and development programs
- **C** Autocratic management styles with minimal worker participation
- **D** Implementation of flexible working conditions

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 measure of effectiveness clearly demonstrates problems in the employment relationship?

- **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

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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

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 are 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 Explain the importance of a strong and positive corporate culture to the success of a business from a human resource management perspective.

2 Describe how staff absenteeism may not be a key indicator of effective human resource management.

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.

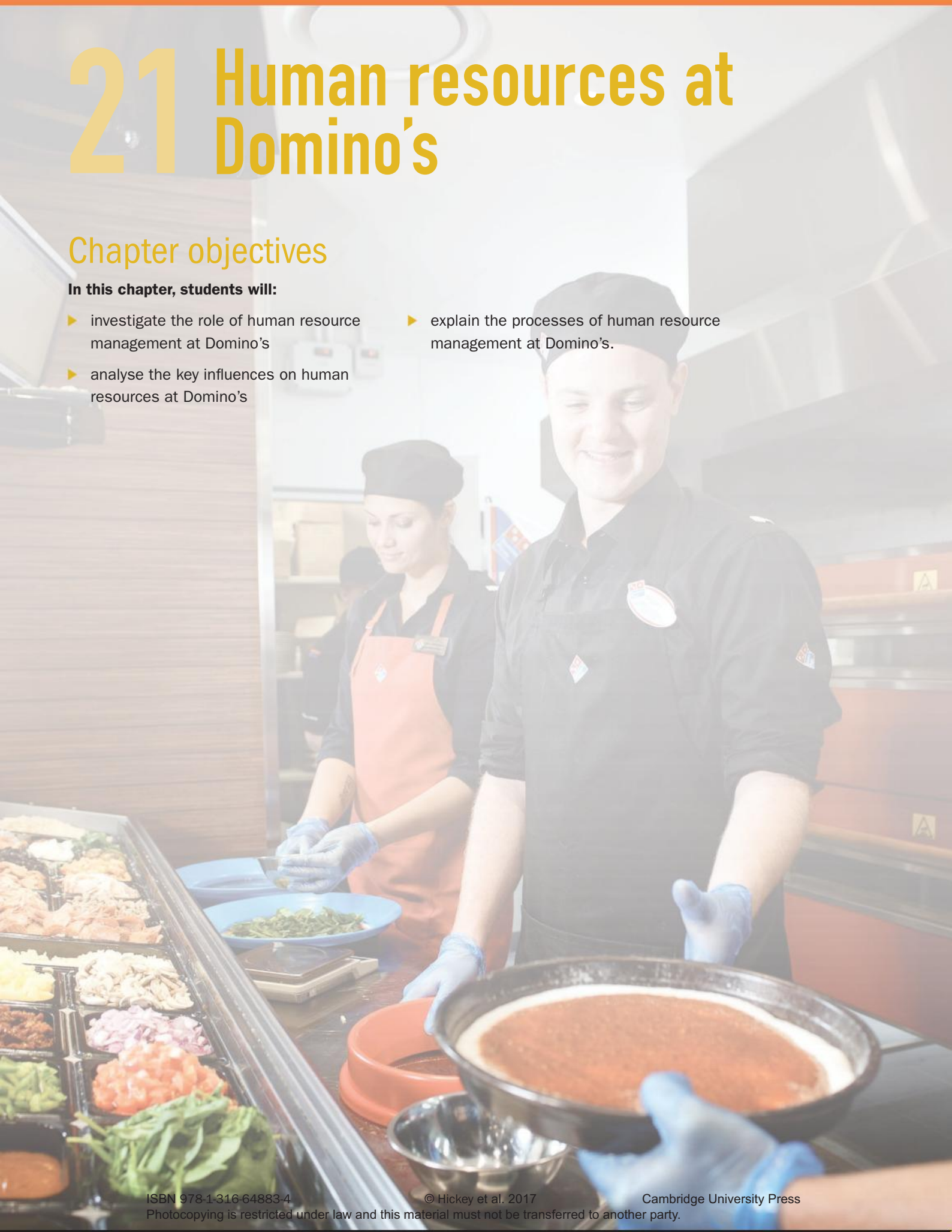
ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

21 Human resources at Domino's

Chapter objectives

In this chapter, students will:

- investigate the role of human resource management at Domino's
- analyse the key influences on human resources at Domino's
- explain the processes of human resource management at Domino's.



ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

21.1 Role of human resource management

The human resources team of Domino's in Australia plays a vital role: it is intimately involved in all aspects of the company, aiming to create a team of staff that matches Domino's business model. Domino's has realised that its success is strongly dependent on the skills and motivations of its franchisees and employees. As a business, it fits into the retail or service industry, and is therefore heavily reliant on its labour force to sell its goods. The most vital functions of the Domino's business – preparing pizzas on time to certain specifications – cannot be outsourced; therefore, Domino's must improve staff training or use new technology to increase revenue growth. Domino's is committed to creating a highly engaged and positive workplace culture in which its visions, values and customer service ethic are at the heart of everything it does.

Strategic role of human resources

In order to achieve its vision of being number one in people and number one in pizza, Domino's places a high priority on maximising the potential of each of its employees. The human resources team is responsible for acquiring and maintaining top talent. A dedicated human resource training team works closely with Domino's head office staff and in-store staff to fully train and educate team members in all aspects of the company, including workplace health and safety, food safety, delivery procedures and customer service. The team also develops short-term training courses to provide ongoing career development for staff. Training is a key part of the business in ensuring continued success.

Interdependence with other key business functions

Domino's is Australia's most popular pizza brand, and as a large organisation several of the key business functions rely on successful human resource initiatives. Domino's openly promotes its employee-based core values and always strives to fulfil its company vision ('No. 1 in People, No. 1 in Pizza') and its mission ('Sell More Pizza, Have More Fun!'). Results from other key business functions such as finance and operations are based on the ability of the human resources sector to create an environment for employees that allows them to develop and remain in the business environment.

Outsourcing

Human resource functions

The size and scope of the Domino's approach lends itself to having a strong business model with clear corporate policies and training systems in place. Domino's therefore maintains an in-house human resources team, as part of its head office hierarchy, rather than outsourcing this function. This is one way that the head office of Domino's is able to support its franchisees.

Using contractors

Domino's often utilises contractors for a range of its operations to fulfil short-term job requirements or contracts when required. This is designed to ensure the company is always able to grow and expand. However, with its internal head office teams in place, Domino's does not require external contractors in terms of human resources.

21.2 Key influences

Domino's workforce can be influenced by a number of different factors and relationships developed and maintained by the organisation.

Stakeholders

As with any business of its size, Domino's success depends on effective relationships with its stakeholders. Domino's has determined that its key stakeholders are: its customers (first and foremost), its employees and team members in all areas of franchises and corporate staff, its shareholders, unions, community groups, governments and regulators, and its suppliers.

Customers

For Domino's, customer feedback plays a vital role in maintaining its 'People Powered Pizza' brand ethos as the company can take any suggestions or advice from customers to improve its customer service. If customers would like to provide feedback or are experiencing any problems, they are encouraged to contact Domino's on its toll-free feedback line or leave feedback online through a form available on the Domino's website.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 21.1 Domino's has established that customers are its key stakeholders.

Employers

Domino's is a large international franchise pizza delivery corporation spanning over 80 countries. In Australia, Domino's Pizza Enterprises Limited is a publicly listed company that operates as a franchisor and operator of Domino's fast-food restaurants. It operates a hybrid business model, with approximately 10 per cent of stores controlled directly by the company and the remainder operated by franchisees. The company has a network of around 2000 Domino's stores, including more than 700 in Australia and New Zealand.

In terms of human resource management, Domino's Pizza Enterprises franchisees receive a range of support services from the organisation. Benefits and included services for franchisees include:

- Use of one of the world's most recognised food brands, Domino's
- A dedicated store territory
- Support through all stages of the store building process [site selection, lease negotiation, store fit-out]
- Professional and comprehensive training covering every aspect of owning and operating a Domino's store
- Local franchise consultant to help with ongoing store operations, including meeting health and safety regulations and improving operational effectiveness and efficiencies by adopting best practice in stores
- Ongoing training, infrastructure and marketing support

Employees

Central to Domino's stakeholder relationships are those with its employees; or as CEO Don Meij refers to them, 'Dominoids'. Domino's human resource department has a key role to play in recruiting and developing staff for the business.

Domino's is committed to living by its brand ethos of 'People Powered Pizza' to provide its customers with the best possible service. As a result, Domino's relies heavily on its employees to operate with their maximum potential to create the atmosphere to deliver this level of customer service. Outlined in Domino's 'Slow Where It Matters, Fast Where It Counts' philosophy, the business highly values the skills of its employees and is determined to allow them to reach their full potential in a safe, inspiring and diverse work environment.

In pursuance of the highly engaging, fun workforce envisaged by the business, Domino's has thoroughly consolidated the guidelines its employees are to follow. Domino's attempts to achieve a fun and ethical workplace by conducting business according to its core values.

- Treat people as you'd like to be treated.
- Produce the best for less.
- Measure, manage and share what's important.
- Think big and grow.
- Incentivise what you want to change.
- Set the bar high, train, never stop learning.
- Promote from within.
- We are not ordinary, we are exceptional.

These are instilled as part of induction and training programs and are also one of the ways in which the Domino's leadership team holds itself accountable.

Employer associations

As the majority of Domino's stores are owned and operated by franchisees in Australia, the most relevant employer associations are those that offer specialised assistance to franchisees. Franchisee associations offer support and advice for entrepreneurs who decide to pursue franchising opportunities. For instance, membership is available in the Franchise Council of Australia, a government body, while the website franchisebusiness.com.au also offers independent advice. Periodical financial magazines such as *Australian Business Review* can also offer valuable information on franchising opportunities.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Unions

At Domino's, when a new employee is hired they may choose to have a certain amount of their pay automatically deducted to service union fees. Employees are represented by the Shop, Distributive and Allied Employees' Association (SDA), which is the union that covers retail and fast-food companies in Australia.

Unions ensure there is transparency in dealings between employers and employees, and the human resource department often represents an employer in any dealings with a union. Unions are very effective in representing employee interests and ensuring all issues between employers and employees are resolved effectively such that the interests of both parties are aligned. For example, an employer must recommend that employees subject to contract agreements become part of a union and that the employer conducts quarterly meetings to review issues affecting employees. Ultimately, unions help influence human resource departments to promote a positive industrial environment. This helps businesses such as Domino's to achieve part of its core values: supporting staff.

Government organisations

One of the most important and influential stakeholders in the employment relationship process at Domino's is the Australian government. The government is responsible for establishing the legal framework within which employers, employees and trade unions operate concurrently. Employers, employees and trade unions are all expected to abide by the regulations that the government and relevant tribunals set up.

As the health and safety of food preparation and consumption becomes more important, most of the regulation and policy that affects the industry centres on food safety. The *Australian New Zealand Food Standards Code*, drafted by Food Standards Australia New Zealand (FSANZ), has the highest level of authority in the regulation and government of food-service establishments, including pizza takeaway and restaurants. Areas of the code that affect pizza establishments mostly dictate food safety practices, maintenance of food premises and equipment, and food preparation. The code is enforced by state and territory legislative bodies.

As retailers of food, pizza establishments are subject to regulations such as the *Competition and Consumer Act 2010* (Cth), with a requirement to adhere to marketing and product claims and not make false or misleading claims. As a result of the growing prevalence of online orders, industry players with an online presence are subject also to privacy policy agreements, providing safety for sensitive consumer information such as addresses and contact phone numbers.

Society



Locally owned and operated, Domino's strongly believes in giving back to Australian and New Zealand communities. Providing financial assistance to communities in difficult times is at the core of these beliefs. Over the years, Domino's has donated tens of thousands of pizzas and hundreds of thousands of dollars to Australian and New Zealand local communities through initiatives like Doughraisers, pizza donations in times of natural disasters, and monetary donations through its 'Give for Good' program.

Legal

Another influence on the human resources of Domino's is legal concerns. The corporate legal team's role is to assist in the management of legal risk in the business, preparing key contracts and understanding the impact of decisions made by government authorities.

The employment contract



Domino's adheres to standard contracts under Australian workplace law. A 2010 decision by Fair Work Australia approved an enterprise agreement between the SDA and Domino's called *SDA – Domino's Pizza Agreement 2009*. The *Fair Work Act 2009* (Cth) is the basis of the agreement, which reflects that Domino's accepts the minimum standards of treatment of employees under the government's National Employment Standards guidelines.

Domino's also has specific policies in place which all staff need to acknowledge in terms of intellectual property and privacy rights. All corporate head office staff are required to sign a confidentiality agreement. If they are leaving to work for a competitor this may affect their notice period.

Work, health and safety and workers compensation

Each team member undergoes work, health and safety (WHS) training when they commence employment at Domino's. This training is completed

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

in-store and online at regular intervals. If a WHS incident occurs, store staff are required to complete an incident report form. This form is reviewed by head office and forwarded on to the appropriate body for further investigation. Regional leaders are also all certified in senior first aid. In terms of workers compensation for workplace accidents, Domino's adheres to its stated requirements outlined in the *SDA – Domino's Pizza Agreement 2009*.

Anti-discrimination and equal employment opportunity

Domino's proudly employs people of all ages, races, genders and abilities and has a zero tolerance policy for any discriminatory behaviour. Domino's has in place a diversity program led by the Group HR manager, which is integrated into leadership training. This diversity program is aimed at recognising and promoting differences within the business.

The industrial relations team provides training to franchisees and store managers with regards to indirect and direct discrimination when it comes to rostering and employment. If Domino's is made aware of any issues of discrimination, the persons involved are required to complete mandatory training in the corresponding area.

In terms of equal opportunity, one initiative the Domino's Board has instigated is to improve the participation rates of women in the Domino's workforce, and in positions of power in particular. In its 2016 Annual Report, Domino's reported the following percentages of employment of women in its workforce:

Role	Women (%)
Non-executive directors	20
Leadership team members	8
Other	30
Total in the whole organisation	30

The Domino's Board has several initiatives in place in order to improve these figures, which are all ongoing goals for the business.

Economic

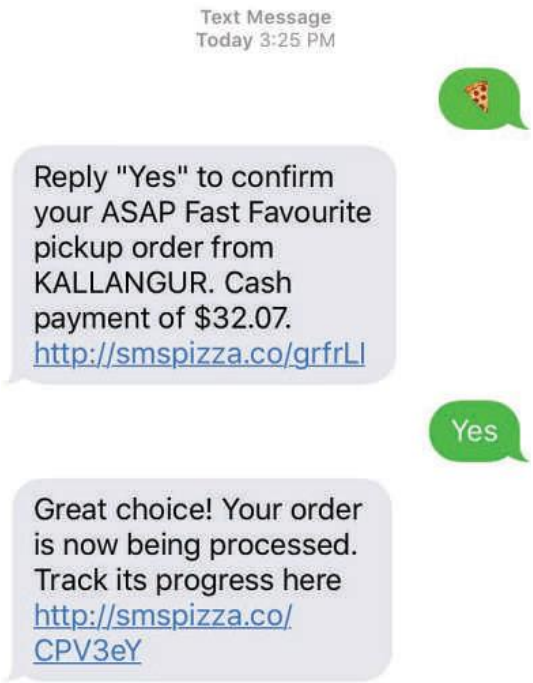
The current trend in the Australian takeaway pizza market is towards lower-priced but higher-quality products. Essentially, businesses like Domino's are striving to improve convenience for consumers. As a part of its 'Slow Where It Matters, Fast Where It Counts' philosophy, a number of Domino's franchises have reduced their delivery areas to improve customer service, as well as split delivery areas to make way for new stores. This ensures that each store is able to deliver its pizzas on time, meet and even exceed customer expectation, and Domino's 'Delivery Experts' are able to perform more deliveries.

During an economic downturn, consumers are often encouraged to purchase from low-cost meal providers. This may have the benefit of increasing sales for Domino's.

Technological

According to a 2016 Australian pizza industry report by the IBISWorld group, 'Domino's growth has been due to a combination of technology, product development, acquisition and organic expansion'. Technology has played a key role in the success of Domino's operations.

Domino's is consistently introducing new innovations and running new projects to increase efficiency in-store. These are undertaken primarily with team members and customers in mind. Through the development of mobile applications, easy-to-manage websites and ordering systems that utilise smart devices such as smartwatches and smartphones, customers can order seamlessly through an efficient process. Any new developments in technology are presented to the Franchise Council of Australia, which then approves the implementation into stores.



Source 21.2 Domino's is always looking to technology to help streamline the ordering process.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

One example is the way that Domino's has partnered with technology companies to improve its customer service practices. In 2012, Domino's was the first pizza company to develop an ordering system for Facebook and an iPad ordering app. In 2015, it launched the GPS Driver Tracker, developed with staff safety in mind. By being able to see the employee's current location and ensuring the vehicles are travelling at the correct speed, traffic incidents have been reduced by 50 per cent. It was also found that staff felt more comfortable knowing that a manager was aware of their whereabouts at all times and would receive an alert in case of a vehicle being stationary for an extended period of time.

There has also been significant investment to provide stores with different transport options for their delivery staff, including electric scooters and e-bikes.



Source 21.3 Domino's has invested in different transport options for delivery staff, such as e-bikes.

Domino's continues to use technology to keep ahead of the competition. Its human resources department is responsible for hiring staff with specialised skills or keeping existing staff trained to use new technologies as a key driver of the business.

Social

Domino's in-store team members work off a flexible part-time roster. Employees often have study commitments, other jobs, families, charitable commitments and more, so maintaining a work–life balance is very important to them.

One of the reasons Domino's is an attractive employment opportunity is because of the flexible nature of the shifts. Due to the fact that most franchises operate during the day and into the evening, there is a variety of shifts available to employees.

Ethics and corporate social responsibility

Ethics

The Domino's Board has a Code of Conduct that all employees must follow. As outlined in the 2016 Annual Report, this requires all directors, executives and employees to:

- act honestly, in good faith and in the best interests of the Company as a whole;
- act with high standards of personal integrity;
- comply with the laws and regulations that apply to the Company and its operations;
- not knowingly participate in any illegal or unethical activity;
- not enter into any arrangements or participate in any activity that would conflict with the Company's best interests or that would be likely to negatively affect the Company's reputation;
- not take advantage of the property or information of the Company or its customers for personal gain or to cause detriment to the Company or its customers; and
- not take advantage of their position or the opportunities arising therefrom for personal gain.

This code is instilled as part of induction and training programs and is part of the way in which the leadership team holds itself accountable.

If customers or staff believe that Domino's has breached their privacy rights in any way in terms of information collection, they can lodge a complaint to Domino's privacy policy coordinator who will determine the steps required to resolve the complaint.

According to Domino's *Business Partner Code of Practice*, the company expects its suppliers to respect human rights, diversity, environmental management, and workplace health and safety laws and standards. Business partners are also expected to have their own risk management policies in place, conduct their

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

business with integrity, and ensure animal welfare is a priority. Domino's conducts semi-regular audits of its suppliers to ensure they are following correct procedures.

Corporate social responsibility

As a locally owned and operated business, Domino's places strong importance on giving back to and assisting local communities as much as possible. This is done through donations of countless amounts of pizzas and monetary donations to various organisations. Regular 'Doughraiser' fundraisers take place in Domino's stores weekly, where the aim is to support local communities through the sale of pizzas with proceeds going to chosen charities, schools or foundations.

The 'Domino's Give for Good' initiative aims to develop sustainable practices and innovative ideas to make a difference in four key categories: education and youth initiatives, disaster relief, food and sustainability, and leadership and entrepreneurship. Individuals and organisations seeking support from Domino's can put in an application to the Domino's Give for Good Group, which meets four times a year and assesses all applications against a published set of criteria.

A recent initiative is 'Chocolate for Charity': 20 cents from every Belgian Choc Lava Cake sold by Domino's goes to the Domino's Give Campaign.

21.3 Processes of human resource management

Acquisition

Domino's has its own job search facility at jobs.dominos.com.au where franchises and store managers can post open positions. Team members also often refer friends and family to join the team. The business can often have potential employees walk in off the street. Potential employees are required to submit an application form and a questionnaire that helps identify which position they would be most suited for. Candidates are then shortlisted from the applications and can proceed to the next stage.

All staff are interviewed, and where applicable (delivery experts, for example) must provide their licence and visa details before starting. Each franchisee and store manager is responsible for choosing appropriate staff, but they often look to Domino's core values to see if they will be an appropriate fit.

Development

All staff at Domino's are required to undergo training with regard to food safety, hygiene, customer service, safe delivery practices, safety in the workplace and more. Training is done through online training modules using the learning management system. The business also has management programs and career progressions set in place for team members to fulfil their career journey at Domino's.



Source 21.4 Required training for staff includes food safety and hygiene.

Maintenance

Domino's has created an environment in which its staff feel recognised and rewarded for their work. Domino's has a particularly strong culture of maintenance, which has aided the business in achieving its goals.

Each franchise store incentivises and rewards staff in its own unique way. The head office encourages team sports days and in-store competitions as well as providing feedback about the working environment to leadership and head office. It also hosts the annual Rally where awards are given out.

When confronted with complaints and concerns regarding its staff members, Domino's will investigate and conduct necessary action. However, it is conscious of the importance of supporting its employees through the relevant processes.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Separation

If a resignation occurs, a team member needs to give the required notice period. This notice period is dependent on the team member's contract type and the duration for which they have been a team member. As many staff are part-time or casual employees, the notice period can be as little as a day or as much as a few weeks. This is also the practice if a franchise needs to make an employee redundant.

In case of a dismissal that occurs as a result of a dispute or grievance, the industrial relations team is made aware if any disciplinary action is taken, and a staff member is dismissed due to breach of conduct. These incidents are usually handled in-store unless further mediation is required.

21.4 Strategies in human resource management

Leadership style

Domino's CEO Don Meij projects a public image that perfectly suits the organisation's mission statement of having fun while selling pizza. However, as the business model is tailored towards franchises, each franchisee would also have its own leadership style in each store in many respects.

Operationally, Domino's teaches two key methodologies: high volume mentality and excellence expected. Store managers and leaders are expected to model these values. Leaders are not required to use a specific leadership style in their approach to these values. However, all employees are encouraged to share their ideas to streamline processes and impact on the businesses in-store with their store manager or franchisee. They are also welcome to submit any ideas to head office through an internal social network. A participative style of leadership would sit well within this structure.

Job design

Each position at Domino's is created so that employees have a range of responsibilities unique to their role while also learning and combining multiple skills that allow them to branch into other roles. This encourages a collaborative team environment where each member brings their own set of skills. Every position is created to enable employees to grow individually as well as with the company and potentially build a set of skills that allows them to advance their role and move up within the corporation and continue building themselves.

For example, one of the key roles at Domino's is the pizza maker. This employee is primarily responsible



Source 21.5 Domino's CEO Don Meij



Source 21.6 A pizza maker's responsibilities include preparing a variety of pizzas and other food items.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

for preparing pizzas and other menu items in a timely and correct manner, which requires niche labour skills. Their responsibilities include:

- Preparing a variety of pizzas and other food items
- Quality control of pizzas
- Hygiene and food safety
- General cleaning duties

Additional responsibilities (if required):

- Meet and greet customers on the phone and in person
- Attending to customer concerns
- Promoting menu items and special offers
- Processing payments: cash and EFTPOS

Recruitment

One of Domino's core values is to promote from within; hence, where possible, the opportunity to move up to a position is given to an internal staff member who is interested in the role. If the role cannot be filled internally, it is advertised externally. As mentioned earlier, Domino's franchises and store managers can post open positions on the jobs.dominos.com.au website.

Training and development

Aligning with its goal of providing its employees with the opportunity to constantly learn and grow, Domino's offers a multitude of optional development programs. These are offered through a mix of hands-on and online training that acclimatise new employees to Domino's products and equipment and further allow team members to excel in their chosen roles.

For team members who wish to advance into a management role, a management training program entitled 'Pizza College' offers a series of short courses in areas such as store security, staff training, customer service and performance management.

Additional training programs are offered to managers and corporate team members who wish to rise and progress their career with Domino's. The Multi-Unit Manager program allows managers showing strong potential to become successful multi-unit supervisors through enhancing their coaching, business management and problem-solving skills, among many others.

Domino's places a high importance on building on the current skills of employees as well as the acquisition of new skills, which is evident through programs such as a rising talent program, leadership development program and driver development program. These programs focus on employees challenging their problem-solving, presentation and relationship-building abilities in order to help them progress in their careers.

Performance management

Domino's takes an administrative stance in terms of performance management. Franchises and corporate offices are recommended to conduct quarterly job performance reviews and are provided with templates for supervisors and store managers to conduct with their staff. The primary method of conducting performance reviews is done by carrying out interviews with managers and assessing their performance over the time period. Completing performance reviews helps to create a shared vision between team members by making sure their interests are aligned. Along with performance evaluation, employee development and incentives are also used to motivate and reinforce employees to excel.

Rewards

Each franchisee or store manager is responsible for rewarding their own staff as they wish within their business. However, franchisees and managers are rewarded through incentive programs. Regional leaders have certain key performance indicators for stores. All employees are provided with the incentive to increase their pay and work their way up throughout the business by meeting targets.

Each year, Domino's annual Rally gives out yearly awards for a variety of categories. From Domino's Delivery Driver of the Year to Manager of the Year, these awards recognise outstanding achievement of staff across the network. The Rally also includes a pizza-making competition that any staff member can enter, with finalists winning a flight and accommodation for the Domino's Rally held in Brisbane.

Global

In Australia, Domino's operates as a local company but is affiliated through branding with the worldwide Domino's network. However, globally, Domino's is constantly changing its strategies, which has enabled it to become one of the largest pizza chain corporations in the world. In the last four years, Domino's has opened over 2000 new stores in 10 countries. By flourishing in emerging international markets, Domino's is seeing growth in many countries. Following its global strategy of diversifying

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

its product range from pizzas to include pastas, sandwiches and side dishes such as desserts, Domino's has also been able to overtake other international franchise rivals.



Source 21.7 Domino's has diversified its product range to include side dishes such as desserts.

Workplace disputes

If staff members have an issue or a dispute with any terms as set out in their agreement when commencing employment at Domino's, a certain procedure is utilised to ensure that all employee grievances are dealt with appropriately. In the first instance, employees must attempt to discuss the matter with a supervisor wherever possible in order to achieve a resolution of the dispute. If the matter is not resolved by consulting a supervisor, it may be referred to the next higher level of management for discussion. Should the dispute remain unresolved, an official from the SDA and a senior representative of the employer may become involved. While the matter is being resolved, all work continues as per normal conditions unless the grievance poses a threat against either party. The employee may be referred to the Fair Work Commission if the matter remains unresolved, with the possibility of being suspended from work on full pay.

21.5 Effectiveness of human resource management

Indicators

Feedback is crucial when implementing effective human resource management strategies. In order to ensure strategies are well received and being used to their full potential, Domino's relies on engagement with its staff.

Corporate culture

Domino's prides itself on possessing a staff that thrive in a family-like culture that places as much importance on being energetic, having fun and being passionate as being results-driven and innovative. The company believes in this methodology of training its staff in order to inspire them to continuously do better and ultimately provide the best possible service to customers.

Changes in staff turnover

Hiring and maintaining enthusiastic and well-equipped staff is an important procedure to ensure a business can provide customers with the best experience possible. Domino's believes in hiring employees with values that correspond with those of the business and training those employees to achieve their maximum potential so that they may grow with the company. Retaining highly trained employees and reducing staff turnover has been shown to boost staff morale and enrich the corporate culture that Domino's works hard to maintain. Domino's approach to reducing staff turnover is concerned with ensuring that those in leadership roles, such as store managers, are of better quality, have better tools and are better incentivised. Following this strategy, store-level employee turnover rates are reduced, managers have the best possible opportunities to thrive and are inspired to constantly grow within the company.

Absenteeism

Domino's has recommended procedures to follow if absenteeism among staff is an issue. Each franchisee or store manager is expected to manage absenteeism through conversations with the staff member. However, the industrial relations team can also become involved to help mediate.

Accidents

Domino's closely measures the number of workplace accidents in its stores and ensures that mandatory WHS training has been completed when new employees commence work. It also performs quarterly audits to ensure that staff are adequately trained.

Levels of disputation

Depending on the nature of a dispute, Domino's has procedures in place to address the problem.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.



Source 21.8 The Domino's culture places importance on being energetic and having fun.

If the dispute cannot be resolved directly by an appropriate manager, either the industrial relations or legal team may become involved, as well as a union representative if the worker is a union member.

Worker satisfaction

Domino's does not have any formal process in place to measure worker satisfaction. However, the fact that it prefers to hire internally and openly encourages staff to help recruit friends and family members, suggests that employees generally enjoy working for the company. When a business prioritises fun as a large part of its mission statement, it is an indication that staff find the working environment to be engaging and that people who enjoy providing customer service are employed. Also, Domino's actively recruits young workers, who would typically engage with the fun workplace ethos and find such employment satisfying.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

END-OF-CHAPTER TASKS

Multiple-choice questions

1 Which of the following best describes the strategic role of Domino's across human resources?

A Maximising the potential of each of its employees
B Educating team members in all aspects of the company, including workplace health and safety, food safety, delivery procedures and customer service
C Developing short-term training courses to provide ongoing career development for staff
D Improving staff training or use new technology to increase revenue growth

2 Domino's uses 'People Powered Pizza' to describe the role of its customers. What does this mean?

A An in-house human resources team is part of its head office hierarchy
B Employees operate with their maximum potential to create the atmosphere to deliver this level of customer service
C The business highly values the skills of its employees and is determined to allow them to reach their full potential in a safe, inspiring and diverse work environment
D Domino's Pizza Enterprises franchisees receive a range of support services from the organisation

3 Which human resource influence has been attributed to the growth of Domino's business?

A The government who is responsible for establishing the legal framework within which employers, employees and trade unions operate concurrently
B Legal Influences as Domino's also has specific policies in place which all staff need to acknowledge in terms of intellectual property and privacy rights
C Domino's proudly employs people of all ages, races, genders and abilities and has a zero tolerance policy for any discriminatory behaviour
D Technological influences through the development of mobile applications, easy-to-manage websites and ordering systems that utilise smart devices

4 Which two strategies does Domino's use to maintain its staff?

A Increased remuneration and promotional opportunities
B Flexible working hours and child care facilities
C Work from home opportunities and equal employment programs
D Team sports days and in-store competitions

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

5 Which of the following reasons describes why Domino's is highly regarded as a potential employer?

A The diverse career opportunities offered by the business
B The flexible nature of the shifts
C Tracking devices for drivers allowing employee's current location and ensuring the vehicles are travelling at the correct speed
D The industrial relations team provides training to franchisees and store managers with regards to indirect and direct discrimination

Short-answer questions

1 Examine the role of two competing stakeholders in the Domino's Human Resource function.

2 Examine one strategy Domino's uses to promotes its corporate social responsibility.

Extended-response question

With reference to Domino's, examine how processes of human resource management influence the indicators of effectiveness.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Solutions to end-of-chapter multiple-choice questions

Chapter 1

1 C
2 D
3 D
4 B
5 A
6 A
7 C
8 B
9 C
10 A

Chapter 2

1 C
2 A
3 A
4 A
5 A
6 C
7 D
8 C
9 A
10 A

Chapter 3

1 B
2 B
3 C
4 C
5 C
6 C
7 B
8 A
9 B
10 D

Chapter 4

1 B
2 A
3 B
4 A
5 C
6 B
7 A
8 C
9 A
10 C

Chapter 5

1 D
2 C
3 C
4 C
5 B

Chapter 6

1 D
2 A
3 B
4 C
5 C
6 C
7 A
8 A
9 A
10 C

Chapter 7

1 D
2 A
3 A
4 A
5 B
6 B
7 B
8 B
9 A
10 B

Chapter 8

1 A
2 C
3 B
4 A
5 C
6 D
7 B
8 B
9 C
10 D

Chapter 9

1 A
2 A
3 B
4 D
5 A
6 B
7 C
8 C
9 C
10 A

Chapter 10

1 B
2 A
3 C
4 D
5 C

Chapter 11

1 A
2 B
3 B
4 C
5 A
6 A
7 C
8 B
9 B
10 D

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Chapter 12

1 B
2 D
3 B
4 D
5 C
6 C
7 C
8 D
9 A
10 C

Chapter 13

1 D
2 C
3 A
4 B
5 A
6 B
7 A
8 A
9 C
10 B

Chapter 14

1 D
2 D
3 B
4 B
5 C
6 D
7 D
8 A
9 D
10 B

Chapter 15

1 A
2 B
3 D
4 B
5 C

Chapter 16

1 D
2 C
3 A
4 A
5 A
6 D
7 C
8 A
9 B
10 B

Chapter 17

1 A
2 D
3 B
4 A
5 A
6 A
7 D
8 B
9 C
10 A

Chapter 18

1 B
2 D
3 B
4 D
5 C
6 B
7 C
8 D
9 A
10 D

Chapter 19

1 A
2 A
3 D
4 D
5 A
6 D
7 A
8 B
9 C
10 A

Chapter 20

1 C
2 C
3 C
4 B
5 A
6 B
7 A
8 A
9 B
10 A

Chapter 21

1 A
2 C
3 D
4 D
5 B

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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
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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 by 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 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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).

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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 size of the business compared to its competitors in the same market.

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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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
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 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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

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.

ISBN 978-1-316-64883-4
© Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

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.

Triple bottom line (TBL)
A measure of a business's financial, social and environmental performance.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

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.

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

Index

absenteeism 379–80, 396
accidents 380, 396
accounting and finance function 107–8
accounts payable 201, 273
accounts receivable 199, 270–1
accounts receivable turnover ratio 251, 303
acquisition (human resources) 346–50, 393
advertising 123–4, 126–30, 165, 186
  see also marketing
age, market segmentation and 157
Age Discrimination Act 2004 (Cth) 334
agreements 327, 332–3, 390
Airbnb 20
Aldi 119, 173
anti-discrimination legislation 334, 391
Apple Inc. 60, 163, 378
appreciation 282
arbitration 327, 374
assets
  current 199, 200, 269–72
  intangible 257
  matching finance to 238
  sale of unwanted 212
  valuing 256–7, 304
attitudes, customer choice and 120
audits 260
Australian Competition and Consumer Commission (ACCC) 72, 129, 220
Australian Consumer Law (ACL) 124
Australian Council of Trade Unions (ACTU) 326
Australian Government Treasury 220
Australian Prudential Regulation Authority (APRA) 220
Australian Securities and Investments Commission (ASIC) 195, 220, 223, 224
Australian Securities Exchange (ASX) 217–18, 223
Australian Stock Exchange 223
Australian Taxation Office (ATO) 260
authoritarian leadership 363
availability of funds 226
awards 327, 331–2, 353

bad debts 271
balance sheets 244–7, 300–1
bankruptcies 195
banks 221
barriers, to trade 18
batch production 40
behavioural segmentation 159
beliefs, customer choice and 120
benchmarking 74, 379
benefits sought (behavioural segmentation) 159
Better Off Overall Test 327, 333
bill of exchange 214, 284
BMW 74
Borders bookstores 139
borrowing 213–16, 238, 273–4
bottlenecks 57
BPAY 221
brand awareness 105, 127, 164–6
branding 161, 170, 185–6, 188, 395–6
break-even point 59
budgets 233–4, 266
business challenges 6
business functions, interdependence between 10–11, 106–8, 204–5, 312–13, 388
business life cycle *see* product life cycle
business operations, influences on *see* influences on business operations
businesses, global 17

capital 212
capitalised expenses 255–6, 304
carbon tax 24
cash (current assets) 269–70
cash flow management 266–8, 305
cash flow statements 239–41, 266–7, 301–2
casual employment 333, 347
Centre Court Wimbledon Debentures 215
certified agreements 327, 332–3, 390
Chanel 158
change, overcoming resistance to 76–8, 96–7
Channel Seven (Australia) 142
channels, distribution 166–7, 168
Chevron 28
choice, customer *see* customer choice
clean payment 285
Coca-Cola 171
code of conduct 29–30, 392
Coles Supermarkets Australia 172
collective bargaining 373
commercial bills 214, 284
common law 25
Commonwealth Bank 370
communication process (promotional) 165–6, 187
Communications Council 126–7
company tax 224
comparative ratio analysis 252–3, 303
competition, fair 129, 183
Competition and Consumer Act 2010 (Cth) 50, 72, 123, 124, 125–6, 390
competition-based pricing 163
competitive advantage 3, 56
competitive positioning 172
competitor analysis 183
components 36
computer-aided design (CAD) 21
computer-aided manufacture (CAM) 22
conciliation 327, 373–4
consumer laws 123–6, 182
consumer markets 110, 145–6, 181
consumers
  global 19
  protections for 50, 123–6, 182
contract for service 315
contract of service 315
contractors 314–15, 334, 388
contracts, employment 329, 333–4, 390
control, of business functions
  Domino's 184, 298–302
  financial management and 239–47, 298–302
  marketing process and 147–9, 184
  operations processes and 46–8
controls, financial 236, 298
corporate culture 378–9, 396
corporate social responsibility (CSR) 28–30, 338–9, 393
Corporations Act 2001 (Cth) 224, 259
cost (performance objective) 59, 94
cost centres 277
cost controls 275–8
cost leadership 5–6, 88
cost-based competition 23–4, 90
cost-plus pricing 163
Council of Financial Regulators 220
credit card 213, 274
credit policy 251
credit rating 273
creditors 201, 237
critical path analysis (CPA) 44
cultures, globalisation and 20
currencies 17–18, 280–2
current assets 199, 200, 269–72
current liabilities 201, 273–5
current ratio 248, 302
customer choice 104, 118–22, 181–2
customer intimacy (competitive positioning) 172
customer service 48–9, 93, 169
customers, as inputs 38, 91, 388
customisation 7, 58–9, 94, 188

data analysis and interpretation 142
data collection (primary and secondary) 140–2
database maintenance 353
debentures 215
debt finance 212–16, 221, 236–8, 273–4, 296
debt repayments 258, 304
debt to equity ratio 248, 253, 303
debtors 200
debts, bad 271
delegative leadership 364
demand, variation in 41, 42, 92–3
demand-based pricing 162
demerit goods 128
demographic segmentation 157–8
dependability (performance objective) 57, 94
depreciation 17, 256, 257
deregulation 356
derivatives 286–7
development (human resources) 351–2, 393
Dick Smith Foods 205
differentiation, product 7, 88, 160, 170
direct costs 59
discrimination, legislation against 334, 391
dismissal 357, 394
disputes, workplace 327, 372–4, 380, 396–7
distribution
  of payments 267
  product 166–8, 171–2, 187

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

dividends 196
Domino's (case study)
about 88
change and 96–7
Code of Conduct 392
cost-based competition 90
economic influences 89
finance at 294–306
globalisation 89, 97
human resources 388–97
inputs 91–2
inventory management 95–6
marketing 180–8
new product design and development 95
operations management 88
operations processes 91–4
operations strategies 94–7
outputs 93–4
outsourcing 95
performance objectives 94–5
quality expectations 90
quality management 96
supply chain management 95
sustainability, social and environmental 91
technology 89–90, 95
transformation processes 92–3
Domino's Robotic Unit (DRU) 90
drawings 196
driving forces 76
duties, employee and employer 330–1

e-commerce 64
economic cycle 335
economic influences
on human resources 335–6, 391
on marketing 121, 182
in operations management 89
economic outlook 225–6
economies of scale 5, 79–80, 97
efficiency
definition 4
financial management and 198–9, 250–1, 295–6, 303
EFTPOS 221
electronic data interchange (EDI) 64, 68–9
e-marketing 169, 188
Employee Share Acquisition Plan (ESAP) 370
employees 324
benefits and rewards 325, 353–5, 370–1
definition 314–15
Domino's 389–97
duties of 330–1
employer relationship with 331–3
motivation of 353–5
needs of 347
performance management of 368–70, 395
recruitment 348, 366–7, 395
separation 355–7, 394
training and development of 77, 351–2, 367–8, 395
turnover 353, 379, 396
employer associations 324, 389
employers 323–4, 330–3, 389
employment 105
contracts 329, 333–4, 390
types of 333, 347
employment relations function 107, 346
see also human resource function
employment standards 332
enterprise agreements 327, 332–3, 390
entrepreneur 211
environmental sustainability 27, 30, 91
equal employment opportunity 391
equipment, purchasing new 76–7
equity finance 212, 217–18, 236, 237, 296
established technology 68–9
establishment stage (product life cycle) 137, 195
ethical issues, related to financial reports 259–60, 304–5
ethical responsibility 29–30, 126–30, 182–3, 338–9, 392–3
euro 280
exchange rates 280–2
exclusive distribution 167
executive summary 136
expense minimisation 277–8
expense ratio 250–1, 303
external sources
of finance 211, 212–19, 296
of secondary data 141–2

facilities 38, 46, 92
factoring 214, 268
Fahour, Ahmed 349
fair competition 129, 183
Fair Trading Act 1987 (NSW) 50, 72
Fair Work Act 2009 (Cth) 327, 332, 390
Fair Work Australia 327
Fair Work Commission 327
Federal Court of Australia 327
FIFO (first in, first out) system 71
finance
assets matched with 238
external sources 211, 212–19, 296
internal sources of 211, 212, 296
finance companies 221–2
finance function
definition 107
other business functions and 10–11, 107–8, 180, 204–5, 313
financial controls 236, 298
financial forecast, developing 147–8
financial institutions 220–3
financial management, global 280–7, 305–6
financial management, influences on 211–28
Domino's 296–7
external sources 211, 212–19, 296
financial institutions 220–3
global market influences 224–6
government influences 224, 297
internal sources 211, 212
financial management, processes of 233–62
Domino's 298–305
ethical issues in financial reports 259–60, 304–5
financial ratios 248–54, 302–3
financial reports, limitations of 255–9, 303–4
monitoring and controlling 239–47, 298–302
planning and implementing 233–8, 298
financial management, role of 195–206
Domino's 294–6
interdependence with other business functions 204–5
objectives 195–204, 295–6
strategic role 195
financial management strategies 266–87
cash flow management 266–8, 305
Domino's 305–6
global financial management 280–7, 305–6
profitability management 275–80, 305
working capital management 269–75, 305
financial managers, role of 233
financial needs, planning for 233
financial ratios 248–54, 302–3
financial reports/statements
Domino's 298–305
ethical issues related to 259–60, 304–5
limitations of 255–9, 303–4
notes to 259, 304
types of 234, 239–47, 266–7
financial risks 18, 236, 298
financial system, regulation of 220, 224
financial years 258
fiscal policy 122
Fitbit 199
fixed charge 215
fixed costs 59, 276
fixed-term contracts 334
flexibility (performance objective) 58, 94–5
flexible manufacturing systems (FMS) 45
floating charge 215
flow production 40
Food Standards Australia New Zealand Act 1991 94
Fortescue Metals 339
Foxconn 6
Foxtel 138
franchisees (Domino's) 181, 389
fuel prices 37, 129, 286
full-time employment 333, 347
fund availability, global market and 226

Gantt charts 43
gearing 202, 248–50, 253, 303
gender, market segmentation and 157
gender pay gap 328
geographic markets, expanding into 143
geographic segmentation 156–7, 295
global branding 170, 188, 395–6
global environments, scanning and learning about 80
global market influences 224–6
global marketing 170–3, 188
global sourcing 64–6, 78–9, 97
global web strategy 79
globalisation
business functions influenced by 16–20, 78–82, 97, 280–7, 305–6, 372
currencies and 17–18
definition 16
different cultures and 20
Domino's 89, 97
employment impacts of 335–6
global businesses and 17
global consumers 19
outsourcing and 17, 66–7, 336
technology and 20
trade agreements and 18–19
goals 195

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

goods
in different industries 7–8
differentiation of 7
Domino's 185
marketing of 103–6, 161
restricted 128
see also products
goodwill 257
government
influences of 121–2, 182, 224, 297
organisations 326–8, 390
policies 24, 122, 220
grants 219
Graphene 81
Great Wall (car manufacturer) 47
green marketing 30
grievance procedures 373
gross profit 197–8
gross profit ratio (GPR) 250, 303
growth (financial objective) 198, 295
growth stage (product life cycle) 137

Hasbro 106
Haval 47
health and safety, occupational 334, 390–1
hedging 18, 285–7, 305
hierarchy of needs 118–19
horizontal integration 62
Huawei 81
human resource cycle 346–58
human resource department 323–4
human resource function
definition 107
Domino's 91–2
other business functions and 10–11, 38, 107, 180, 205, 312–13, 388
technology in 22
human resource management 311–16
definition 311
Domino's 388–97
effectiveness of 378–82, 396–7
interdependence with other business functions 312–13, 388
outsourcing 314–16, 388
strategic role 311–12, 388
human resource management, processes of 346–58
acquisition 346–50, 393
development 351–2, 393
Domino's 393–4
maintenance 353–5, 393
separation 355–7, 394
workplace disputes 372–4
human resource management, strategies 363–76
Domino's 394–6
global 372
job design 365–6, 394–5
leadership style 363–4, 394
performance management 368–70, 395
recruitment 366–7, 395
rewards 370–1, 395
training and development 367–8, 395
human resources
corporate social responsibility and 338–9, 393
definition 311
Domino's 388–97
key influences on 323–42, 388–93
outsourcing of 314–16, 388
Human Rights and Equal Opportunity Commission 328, 334
Hyundai 160

IGA supermarket chain 110
implementation
financial management 233–8, 298
marketing process 147, 184
implied warranty 125
income, market segmentation and 158
income statements 234, 242–3, 298–9
indicators, human resource management 378–81, 396
Indigenous Cadetship Support program 339
indirect costs 59
induction, new employee 350, 367–8
industrial disputes 327, 372–4, 380, 396–7
industrial markets 109–10
industries
classifications and sectors 8–9
goods/services in 7–9
outputs from specific 48
technology specific to 21–2
inertia (operations strategies) 78
inflation, impact of 335
influences on business operations 16–31
corporate social responsibility 28–30
cost-based competition 23–4
at Domino's 89–91
environmental sustainability 27, 30
globalisation 16–20
government policies 24
legal regulation 25–6
quality expectations 23
technology 20–2
information, as inputs 37, 91
ING Australia Holdings 236
Initial Public Offering (IPO) 223
Innovation Connections program 25
inputs 3, 36–9, 66, 79, 91–2
insolvency 239
Institute of Chartered Accountants Australia 259, 352
institutions, financial 220–3
insurance premiums 276
intangible assets 257
intangible benefits 161
intellectual property 81
intensive distribution 167
interdependence, of business functions 10–11, 106–8, 180, 204–5, 312–13, 388
interest rates 226, 282–3
intermediate markets 110
internal sources
of finance 211, 212, 296
of secondary data 141
international payments, methods of 284–5
internet marketing 169, 188
intrinsic rewards 354
inventories 69, 168, 271–2
inventory management 64, 69–72, 95–6, 272
investment banks 221
invoices 199, 251
involuntary redundancy 356
involuntary separation 356–7

James Hardie Ltd 28
Jetstar 316
JIT (just-in-time) system 71–2, 272
job description 347
job design 365–6, 394–5
job enrichment 365
job production 40
job rotation 365
job satisfaction 365
job specification 347
Juggad 20

key performance indicators (KPIs) 46, 76
KIIS 106.5FM (radio station) 145
Kmart 149
Kogan.com 218

layout
process 46
reorganising plant 77–8
lead time 57, 61–2
leadership styles 363–4, 394
leading edge technology 68
Learjet 58
learning
about global trends 80
customer choice and 119
Domino's 97
leasing finance 216, 221, 275, 297
legal compliance 29–30
legal framework, human resources and 329–34, 390–1
legislation 26, 324, 334, 391
Lego Group 106
Lenovo 81
letter of credit 284
level of disputation 380, 396–7
liabilities 201, 273–5
life cycle, product *see* product life cycle
life insurance companies 222
lifestyle, customer choice and 120
LIFO (last in, first out) system 71
liquidity 200–2, 248, 253, 302
living standards 338
loans 212–16, 221, 236–8, 273–4, 296
logistics, supply chain 63–4
long-term borrowing 215–16, 238
long-term financial management 203–4
loss leaders 162, 171

Macquarie Group Limited 219
maintenance (human resources) 353–5, 393
market objectives 143–4, 183, 278–80
market research 140–2, 183
market segments/segmentation 145, 156–9
behavioural 159
definition 156
demographic 157–8
Domino's 184–5
geographic 156–7, 295
psychographic 158
market share 105–6, 143, 148–9

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

market skimming 162, 163
marketing
  approaches 108–9, 181
  definition 103
  Domino's 180–8
  global 170–3
  goods and services 103–6
  green 30
  influences on 118–31, 181–3
  processes 136–51, 183–4
  role of 103–13, 180–1
  strategies 156–75, 184–8
marketing, influences on 118–31
  consumer laws 123–6, 182
  customer choice 118–22, 181–2
  Domino's 181–3
  ethical aspects 126–30, 182–3
marketing function
  definition 107
  other business functions and 10–11, 23, 106–8, 180, 204–5, 313
marketing mix 108, 146–7, 161–9, 171–2
marketing process 136–51
  Domino's 183–4
  executive summary 136
  implementation, monitoring and controlling of 147–9, 184
  market objectives, establishing 143–4, 183
  market research 140–2, 183
  marketing strategies, developing 146–7
  situational analysis 136–40
  target market, identifying 144–6, 183–4
marketing profitability analysis 148, 149
marketing strategies 156–75
  developing 146–7
  Domino's 184–8
  e-marketing 169, 188
  global marketing 170–3, 188
  market segmentation 156–9, 184–5
  marketing mix 161–9
  people, process and physical evidence 168–9, 187
  product/service differentiation 160
  revising 149
markets
  consumer 110, 145–6
  Domino's 181
  industrial 109–10
  intermediate 110
  mass 110, 145
  niche 111, 146
  resource 109
  types of 109–11
Maslow, Abraham 118–19
mass markets 110, 145
matching principle 238
materials, as inputs 37, 91
Mattel 106
maturity stage (product life cycle) 138
McDonalds 42, 65
mediation 373
merger 356
minimum wage rates 331
monetary benefits and rewards 353–5, 370
monetary policy 122, 220
monitoring, of business functions
  Domino's 184, 298–302
  financial management and 239–47, 298–302
  marketing process and 147–9, 184
  operations processes and 46–8
mortgages 215
motivation
  customer choice and 118–19, 181
  employee 354
Myer 149
MYOB (Mind Your Own Business) 235

NAB (National Australia Bank) 268, 349, 368
National Employment Standards (NES) 332
National Innovation and Science Agenda 25
negotiations 373
Nerada Tea 104
net profit 197–8
net profit ratio (NPR) 250, 303
Netflix 138
Network Ten (Australia) 142
new issues, of shares 217
niche markets 111, 146
Nike 329
Nivea 158
non-monetary benefits and rewards 354, 370
normalised earnings 255, 303

obsolescence 70
occupational health and safety 334, 390–1
offshoring 67
on-costs 276
operational excellence (competitive positioning) 172
operations function
  definition 107
  other business functions and 10–11, 23, 107, 180, 204, 313
operations management 3–12
  challenges to business 6
  cost leadership 5–6, 88
  Domino's 88
  goods/service differentiation 7, 88
  goods/services in different industries 7–9
  introduction 3
  strategic role 4–7
operations processes 36–51
  Domino's 91–4
  the four Vs and 40–2, 92–3
  influences on 16–31, 89–91
  inputs 36–9, 91–2
  monitoring, control and improvement 46–8
  outputs 48–50, 93–4
  scheduling and sequencing 43–4, 93
  technology, task design and process layout 44–6
  transformation processes 39–48, 92–3
operations strategies 56–83
  Domino's 94–7
  global factors 78–82, 97
  inventory management 69–72, 95–6
  new product/service design and development 60–1, 95
  outsourcing 66–7, 95
  overcoming resistance to change 76–8, 96–7
  performance objectives 56–60, 95
  quality management 72–6, 96
  supply chain management 61–6, 95
  technology 67–9
operations system *see* operations processes
opinion leaders 165
opportunities
  financial management 233
  SWOT analysis 139–40
Optus 352
ordinary shares 217
orientation, new employee 350, 367–8
outputs 3, 48–50, 93–4
outsourcing
  Domino's 95, 388
  globalisation and 17, 66–7, 336
  of human resource function 314–16, 388
  as operations strategy 66–7
  to reduce costs 275–6
  of supply chain 62
overdrafts 213, 274
owner's equity/capital 212

packaging 161–2, 186
participative leadership 364
part-time employment 333, 347
patents 81
payables 201, 273
payments 267–8, 284
penetration pricing 137, 162, 171
people (marketing mix) 169, 187
perception, customer choice and 119
performance appraisals, employee 352
performance management 368–70, 395
performance objectives 56–60, 94–5
performance pay 371
permanent employment 333, 347
personal selling 164
personality, customer choice and 120
physical evidence (marketing mix) 169, 188
place, marketing and 147, 166–8, 171–2, 187
placements, share 218
planning, financial management 233–8, 298
plant layout, reorganising 77–8
policies, government 24, 122, 220
positioning, product 161, 172
post-maturity stage (product life cycle) 138–9
prestige pricing 163
price
  definition 160
  Domino's 186
  global marketing and 171
  marketing mix 146, 162–3
  product differentiation and 160
  quality and 163
  recommended retail price 125–6
price discrimination 125
price points 163
pricing 137, 162–3, 171, 186, 280
primary data 140–1
primary market 223
private company 217
private equity 217
process layout 46
process technologies 45

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

processes (marketing mix) 169, 187–8
product analysis 137
product differentiation 7, 88, 160, 170
product layout 46
product leadership (competitive positioning) 172
product life cycle 137–9
  Domino's 183
  establishment stage 137, 195
  the four Vs and 42
  growth stage 137
  maturity stage 138
  post-maturity stage 138–9
product range 144
product standardisation 170, 188
product-deletion pricing 162
production, types of 40
production approach, marketing and 108, 181
production system *see* operations processes
productive capacity 58
productivity 3, 57
products
  design and development for new 60–1, 95
  Domino's 95, 185–6
  global marketing of 171
  marketing mix 146, 161–2
  marketing of 103–6
  quality 160
  restricted 128
professional development 351–2
profit margin 5
profitability 197–8, 250, 253, 295, 303
profitability management 275–80, 305
profits 195–6, 212
promotion (marketing mix) 146–7, 164–6, 171, 186–7
prospectus 215
psychographic segmentation 158
psychological factors (customer choice) 118–20, 182
psychological pricing 163
public companies 217–18
public equity 217–18
public relations 165
purchase occasion (behavioural segmentation) 159

Qantas Frequent Flyer program 259
quality
  assurance 75, 76, 96
  control 73–4, 76, 96
  Domino's 94, 186
  expectations 23, 90
  management 72–6, 96
  as a performance objective 56–7
  price and 163
  product differentiation and 160
quality circles 75

receivables (current assets) 199, 270–1
record systems 234–5
recruitment 348, 366–7, 395
redundancy 77, 330, 356
regionalism 18
regulations 25–6, 220, 224, 390
relationship marketing 165
remuneration 347
resale price maintenance 125–6
research, market 140–2
research and development 80–2, 97
Reserve Bank of Australia (RBA) 220
resignation 355–6, 394
resolution process, dispute 372–3
resource markets 109
resources
  transformed 37–8
  transforming 38–9
restraining forces 76
retained profit 196, 212
retirement 355
retraining staff 77
retrenchment 336, 356
return on equity (ROE) ratio 250, 253, 303
revenue (Domino's) 297
revenue controls 278–80
rewards, employee 370–1, 395
rights issue 218
risks, financial 18, 236, 298
robotics 21

salaries 353
sale and lease back 275
sale of unwanted assets 212
sales analysis 148
sales forecasts 278
sales mix 278–9
sales objectives 278
sales promotions 165, 187
Samsung 81
scanning, global environments 80, 97
scheduling 43–4, 93
secondary data 141–2
secondary market 223
secured creditor 237
secured loans 221
segments/segmentation, market *see* market segments/segmentation
selection, job applicant 350
selective distribution 167
self-concept, customer choice and 120
selling approach, marketing and 108, 181
separation, employee 355–7, 394
sequencing 43–4, 93
services
  design and development for new 60–1
  in different industries 7–9
  differentiation of 7, 160
  Domino's 185
  marketing of 103–6, 161
  restricted 128
  see also products
share purchase plan 218
shares, ownership of 217–18
shop steward 326
short-term borrowing 213–14, 238, 273–4
short-term financial management 203–4
situational analysis (marketing process) 136–40
skills, job 367
SMART approach, to setting objectives 143
social influences (human resources) 337–8, 392
social responsibility 28–30, 338–9, 393
social sustainability 91
society, workplace practices and 328, 390
sociocultural factors (customer choice) 121, 182
socioeconomic factors (customer choice) 121
sole trader 196
solvency 202, 296
sources
  data 141–2
  of finance 211, 212–19
sourcing, global 64–6, 78–9, 97
specialisation 10
speed (performance objective) 57, 94
staff *see* employees
stakeholders, in human resources 323–8, 388–90
standard of living 103, 104–5
standardisation (global marketing) 170, 188
standards, quality 75
stock
  holding 70–1
  management 69–72, 95–6
  movement 272
stock-out 58
strategic goals 4
strategic plan 195
strategic roles
  of financial management 195
  of human resource management 311–12, 388
  of marketing 103–6, 180
  of operations management 4–7
STREAT 338
strengths (SWOT analysis) 139
subsidiaries, hedging and 18, 286
sugging 130
superannuation funds 222
supplies, definition 37
supply chain management 61–6, 95
sustainability, social and environmental 27, 30, 91
swap contracts 287
SWOT analysis 139–40, 183
Sydney Futures Exchange 223
  see also Australian Securities Exchange

takeover 356
tangible benefits, of products 161
tangible outputs 7
target market, identifying 144–6, 183–4
task analysis 43
task design 45
tasks, job 365–6
taste, in advertising 127
tax 24, 224
technology
  business operations influenced by 20–2
  CAD and CAM 21–2
  customer service and 48
  definition 67
  Domino's 89–90, 95, 391–2
  established 68–9
  human resources and 337
  leading edge 68
  as operations process input 44–5
  as operations strategy 67–9
  robotics 21
Telstra 49, 121, 314
TerraCycle 27

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.

threats
financial management 233
SWOT analysis 139–40
timing issues (financial reports) 257, 304
Toll 63
total quality management (TQM) 75
Toyota 74
trade agreements 18–19
trade credit 214
trade unions 324, 326, 390
trademarks 257
trading bloc 18
training and development, employee 77, 351–2, 367–8, 395
transaction exposure 286
transformation 3
transformation processes 39–48
Domino's 92–3
influences 40–2
monitoring, control and improvement 46–8
process layout 46
scheduling and sequencing 43–4
task design 45
technology 44–5
transformed resources 37–8
transforming resources 38–9
transport logistics 66, 168
TripAdvisor 120
triple bottom line (TBL) 28, 204, 260

UGG Australia 19
unions 324, 326, 390
unit trusts 222
unsecured loans 221
unsecured notes 215–16
usage rates (behavioural segmentation) 159
user loyalty (behavioural segmentation) 159

value add process 39
value propositions (competitive positioning) 172
value-based pricing strategy 171
variable costs 59, 276
variation, in demand 41, 42, 92–3
variety, of production 41, 42, 92
venture capital 219
vertical integration 62, 66
visibility, of operations 41–2, 93
Volkswagen (VW) 74
volume, of production 40–1, 42, 92
voluntary redundancy 356
voluntary separation 355–6

wages 331, 353
warehousing 168
warranties 50, 93–4, 125, 160, 257
weaknesses (SWOT analysis) 139
Westpac 325
wholesalers 110
Woolworths 172
word-of-mouth publicity 165–6
Work Health and Safety Act 2011 (NSW) 334
work patterns, changing 337
worker satisfaction 380, 397
workers compensation 334, 390–1
working capital management 269–75, 305
working conditions 327
workplace disputes 327, 372–4, 380, 396–7
Workplace Gender Equality Agency (WGEA) 328
Workplace Injury Management and Workers Compensation Act 1998 (NSW) 334
World Trade Organization (WTO) 18
world's best practice 75
write off 271

ISBN 978-1-316-64883-4 © Hickey et al. 2017 Cambridge University Press
Photocopying is restricted under law and this material must not be transferred to another party.