

eBook

Preliminary Business Studies 101

David Broadbridge
Sophie Laing-Peach
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NATURE OF BUSINESS

BUSINESS MANAGEMENT

BUSINESS PLANNING



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Preliminary **Business Studies 101**

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First Edition Published 2019 by
 © Get Smart Education Pty Ltd
 PO Box 684 Mona Vale NSW 1660
 Tel: 0425 235 442 Fax: 9012 0988

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ISBN 9780648651611

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 Printed by Razer Graphix

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Chapter 1

The Nature of Business

1. The Role of Business

a) The Nature of Business

A business is an organisation where people work together to satisfy the needs and wants of the community. The word business comes from the word busy and means doing things. There are about 2.4 million active businesses in Australia. Businesses are the engine of the Australian economy.

- Businesses are responsible for providing us with a diverse range of goods and services to satisfy our needs and wants as consumers. Goods are tangible, that is something that you can touch (physical). Services are intangible and don't have a physical form. It is something that is done for you (performed). The services sector makes up a large part of the Australian economy representing over 75% of Australia's GDP.
- Businesses make profit. Profit is the main goal of a business. It is the reward for risk taken in the business. Profit is the money a business makes (Revenue) after it pays all its costs (Expenses). Profit is essential for the longevity (survival) and growth of a business. Profit enables a business to employ staff, borrow money and pay down debt, attract investors, innovate and motivate employees. It is the yardstick that measures the effectiveness (performance) of management. As well as profit maximisation businesses now have a corporate and social responsibility (CSR) to conduct business ethically both socially and environmentally.
- Businesses provide employment to millions of Australians each year. The goods and services that business provides to the community are produced using the knowledge, skills and effort of human resources. About 80% of people are employed by businesses. The remainder work for the government or are self-employed. The industries with the largest number of employees are construction, professional services, retail, hospitality and health.
- Businesses pay an income (salary or wage) to their workforce for providing their labour. Businesses also provide dividends to shareholders and superannuation and bonuses to their employees. This allows the workforce to spend part of its income on satisfying its own needs and wants. When employees' incomes increase, they spend more which has an expansionary effect on the Australian economy.
- Businesses provide choice to consumers. When firms compete, they provide more choice (options). Consumers therefore get the best possible prices, quantity, and quality of goods and services.
- Businesses provide innovation. Innovation is businesses creating more effective processes, products and ideas. Competition among businesses spurs innovation and consumers

benefit with new and better products. Firms may race to be the first to market a new or different technology. A great example is Apple V Samsung with mobile phones. Innovation also helps drive economic growth and increases standards of living.

Case Study Sony's new wireless headphones

Sony's has just released its new WF-1000XM3 wireless earbuds. These are the best in the market because their innovative features.



There are touch controls on each earpiece. You tap the right touchpad to control audio playback, access your voice assistant and answer and end calls. Tapping the right pad allows you to toggle through three sound modes: noise-cancelling mode on, noise-cancelling mode off and a transparency mode that lets ambient sound in.

The earbuds have a sensor that detects when the bud is in your ear and when it's not. When you pull the bud out of your ear, your music will pause. Put it back in and your music resumes. You can use just one earbud to listen to audio or make calls if you want.

You can also get up to 6 hours battery like with noise cancelling on and up to 8 hours with it off. There's also USB-C charging. A 10-minute quick-charge feature gives you 90 minutes of battery life and the charging case delivers three full charges on the go.

- Businesses provide entrepreneurship and risk. An entrepreneur is someone who operates and assumes the risk of a business venture in the hope of making a profit. Entrepreneurs are important because they bring together the money, raw materials, manufacturing facilities, skilled labour and land or buildings required to produce a product or service. They continually innovate and seek out customer needs that the competition is not satisfying.

Entrepreneurs are optimistic and future oriented; they believe that success is possible and are willing to risk their resources in the pursuit of profit. They are fast moving, willing to try many different strategies to achieve their goals of profits. And they're flexible, willing to change quickly when they get new information.



Case Study Naomi Simpson

Naomi founded Red Balloon in 2005 with just \$25000 and a second-hand computer. Red Balloon is now part of the Big Red Group (BRG) which is one of Australia's largest online businesses generating over \$100 million in revenue per year.

- Businesses generate wealth for their owners. As businesses grow and prosper, they increase the value of the funds that owners have invested in the business. They also generate wealth for the community because business profits are taxed and used to fund essential services.



Case Study Andrew “Twiggy” Forrest

Andrew Forrest is the chairman and biggest shareholder in Fortescue Metals (FMG). He is also a large shareholder in other companies like Invex, Vimy Resources and Poseidon Nickel. His personal wealth has just burst through the \$10 billion mark and has just been paid \$654 million in dividends by Fortescue Metals. The billionaire has donated more that \$1.5 billion to charity through his Minderoo Foundation which supports indigenous projects and cancer research.

- Businesses improve our overall wellbeing (quality of life). They can make things faster, more comfortable as well as safer. Businesses can also make us live longer with improved health care. New cars are much safer than old ones. Studies show that drivers are much more likely to have a fatality in an older car. Its one of the reasons younger drivers have higher fatality rates, they often drive older cars. Features of modern cars which make them safer include airbags, anti-lock brakes, reverse cameras, phone safe features, self-braking systems, lane and park assist, laminated high strength automotive glass and vehicle overspeed warning devices. As well as being safer new cars are more comfortable with features such as cruise control, heated seats, remote start, duel zone climate control and Bluetooth streaming.

Case Study Zimmer Biomet



ZIMMER BIOMET

Zimmer Biomet designs and manufactures innovative orthopaedic products including knee, hip, shoulder, elbow, foot and ankle artificial joints. Their products help surgeons treat patients suffering from disorders or injuries to bones and joints alleviating pain and improving the quality of life for lots of people.

2. Types of Businesses

a) Classification of Business

Australian businesses can be classified (grouped) according to size, geographical spread, industry type and legal structure.

■ Size

Businesses, like pizzas, come in 3 different sizes – small, medium and large depending on their number of employees.

A small business has fewer than 20 employees if the organisation is non-manufacturing (service based) and fewer than 100 employees if is involved in the manufacturing of goods.

A medium business has fewer than 200 employees if the organisation is non-manufacturing (service based) and fewer than 500 employees if is involved in the manufacturing of goods.

A large business has 200 plus employees if the organisation is non-manufacturing (service based) and 500 plus employees if is involved in the manufacturing of goods.

■ Geographical Spread

Businesses can be classified as local, national or global depending on the geographical spread of their operations and sales.

Local business operates and sell to a small geographical region within Australia. A local business relies on its own unique name and reputation and does not wear a nationally recognised brand name.

National businesses operate and sell throughout Australia but within our national boundary. Good examples are Coles and Dymocks.

Global businesses operate and sell outside Australia (cross international borders). Global business is much more complex because of the differences in currency, cultures, taste and legal systems. Good examples of Australian global businesses are Commonwealth Bank, QBE Insurance and Amcor.

Case Study QBE Insurance



QBE Insurance is Australia's largest global insurance company, and it offers insurance to consumers in Australia, Europe, United States and the Asia-Pacific region. The company has more than 14,000 employees working in 37 countries around the world.

■ Industry Sector

Businesses can also be classified according to their type of activity (industry).

Primary industries are involved with the growing, harvesting and extracting of raw materials.

Secondary industries are involved with the processing of raw materials into finished products.

Tertiary industries are involved with the provision of services and account for about 75% of the Australian economy. The tertiary sector because of its size is further broken down into Quaternary and Quinary industries. Quaternary industries focus on providing information services. Quinary industries focus on providing domestic services.

Exercise 1.1

Complete the following table

Business	Industry Type
1. Fortescue Metals	
2. Bega Cheese	
3. Jims Mowing	
4. Fairfax Media	
5. Hire a Hubby	
6. National Australia Bank	
7. Justcuts Hairdressing	
8. Huon Aquaculture	
9. Coca-Cola Amatil	
10. Caltex	

■ Legal Structure

Businesses can also be classified according to their legal structure such as sole trader, partnership, company (private or public) and government enterprise.

Sole Trader

As the name implies this type of business is owned and operated by one person though the business may employ staff. The sole trader owns the business, makes all the decisions and gets to keep all the profits. The business is not a separate legal entity from its owners (unincorporated business enterprise). The sole trader is personally responsible for the business' debts

To set up as a Sole Trader you first need to obtain an Australian Business Name (ABN) and a Tax File Number (TFN) through the Australian Taxation Office (ATO). If you want to operate under an actual business name such as 'Vandelay Industries' rather than your own personal name you must register your business name with the Australian Securities and Investment Commission (ASIC).

Advantages of a Sole Trader	Disadvantages of a Sole Trader
<ul style="list-style-type: none"> ■ Simple to create. 	<ul style="list-style-type: none"> ■ The Sole Trader is personally responsible for all debts and losses (unlimited liability). They assume all the risk and responsibility and could lose their assets.
<ul style="list-style-type: none"> ■ Least costly form of ownership to establish. 	<ul style="list-style-type: none"> ■ Business ceases upon owner's death (lack of continuity for the business).
<ul style="list-style-type: none"> ■ Profit incentive (receives all the profits.) 	<ul style="list-style-type: none"> ■ Limited access to capital.
<ul style="list-style-type: none"> ■ Total decision making authority. 	<ul style="list-style-type: none"> ■ Difficult for owner to take time off for holidays and illness.
<ul style="list-style-type: none"> ■ Least regulated form of business ownership. 	<ul style="list-style-type: none"> ■ Business development is limited to the expertise and capabilities of the owner.
<ul style="list-style-type: none"> ■ Business can be discontinued easily or may be sold without needing the consent of others. 	

Partnership

Strictly speaking a partnership is limited to between 2 and 20 partners though some professions are allowed more. The partners own the business, make all the decisions and get to share all the profits. Like the sole trader, a partnership is not a separate legal entity (unincorporated business enterprise). The partners are personally responsible for the business' debts.

To set up a partnership you still need to obtain an Australian Business Number (ABN). The partnership will also need its own Tax File Number (TFN) through the Australian Taxation Office (ATO) however all the partners will have their own TFN for their own income tax return. If you want to operate under an actual business name rather than the personal names of your partners, you must register your business name with the Australian Securities and Investment Commission (ASIC).

A partnership can be formed verbally without any legal process being followed but it is prudent to have a written partnership agreement drawn up by a solicitor before commencing business. The agreement may include such items as:

- Capital to be contributed
- How profits and losses are to be shared
- Managerial roles
- Exit procedures
- Arrangement for salaries

Advantages of a Partnership	Disadvantages of a Partnership
<ul style="list-style-type: none"> ■ Relatively easy and inexpensive to establish. 	<ul style="list-style-type: none"> ■ Partners have a joint and individual liability for debts and actions of all the partners (unlimited liability).
<ul style="list-style-type: none"> ■ There is a broader management base than a Sole Trader which means a wider pool of expertise. This makes it possible to divide the business operation by specialist roles. It also makes it easier for partners to take time off. 	<ul style="list-style-type: none"> ■ Potential for conflict and personality clashes between partners. Like a marriage, friction among partners is inevitable and can be difficult to control.
<ul style="list-style-type: none"> ■ React quickly to changing market conditions (flexibility). 	<ul style="list-style-type: none"> ■ Transferring ownership is difficult. Adding a new partner generally requires the agreement of all the partners.
<ul style="list-style-type: none"> ■ Minimal government regulation (reporting requirements). 	<ul style="list-style-type: none"> ■ Partnership ends with the death and bankruptcy of one of the partners. If the business is to continue, it must be reformed.
<ul style="list-style-type: none"> ■ Greater access to finances from the resources of all partners (Larger pool of capital). 	

Company

A company is a much more complex business structure. A company is an incorporated business enterprise (it is a distinct legal entity from the people who own and manage the business). The owners are not personally responsible for the debts of the business. The owners are called shareholders and the company is managed by directors.

There are basically 2 types of companies:

a) Proprietary (Private) Companies

- Have between 1 and 50 shareholders
- Have the words Pty Ltd in its name
- Are not listed on the Stock Exchange
- Have restrictions on who can buy shares

b) Public Companies

- Have a minimum of 5 shareholders but no maximum
- Have the words Ltd in their name
- Are listed on the Stock Exchange
- Have no restrictions on who can buy shares
- Must publish an Annual Report which includes their financial statements

All companies are governed by the Corporations Act and must be registered with the ASIC. In addition, public companies must comply with the listing rules of the Australian Securities Exchange (ASX).

Advantages of a Company	Disadvantages of a Company
<ul style="list-style-type: none"> Shareholders are not liable for the debts/losses of the business (limited liability), so their personal assets are not threatened. 	<ul style="list-style-type: none"> Forming a company is expensive and is time consuming to set up.
<ul style="list-style-type: none"> Transfer of ownership is much simpler. 	<ul style="list-style-type: none"> There are more legal requirements and government regulation (red tape).
<ul style="list-style-type: none"> Management can be run by a board of independent experts. 	<ul style="list-style-type: none"> Double taxation (The company is taxed on its profits and the shareholders are taxed again on the dividends they receive from those earnings at the personal income tax rate).
<ul style="list-style-type: none"> Much easier to attract finance and grow. 	
<ul style="list-style-type: none"> The company does not have to be wound up upon the change in and or death of one of the owners (perpetual succession). 	

Exercise 1.2 Matching

Match the definition with the correct term below.

1. Person who leads, manages and supervises the running of a company on behalf of shareholders	
2. Governs the standards and behaviour of public companies	
3. Owner of a company	
4. Continuation of a business existence despite the death, bankruptcy or retirement of an owner	
5. Federal Government body that registers and regulates companies	
6. Business owned by one person	
7. A unique identifying number issued to all businesses	
8. Contract between partners to create and govern a partnership	

9. Owners of a business are personally liable for the business debts	
10. A type of company that is listed on the stock exchange and has an unlimited number of shareholders	

Word Bank: ASX, ABN, sole trader, public company, shareholder, director, perpetual succession, partnership agreement, unlimited liability, ASIC.

Government Enterprises (GBE)

Government enterprises are a separate legal entity created by Government to partake in commercial activities on the Government's behalf. These activities provide critical services and infrastructure (seen as integral to our economy and lifestyle). Government Enterprises run as businesses (seek to make a profit and compete against other companies) and they can be either wholly or partially owned by the Government. Good examples are Australia Post and Sydney Water.

b) Factors Influencing Choice of Legal Structure

The decision whether to structure a business as a sole trader, partnership or company depends upon questions regarding size, ownership and finance.

■ Size

As the business expands its legal structure is likely to change. In the establishment stage a business may start off as a sole trader. As the business grows new partners or new shareholders bring in extra finance and skills. Large global businesses may choose to become a public company and list on the ASX.

■ Ownership

If the business owners want complete control to manage all aspects of the business as well as avoiding disputes with other owners, they should opt for a sole trader or "one person" private company business structure. If you are willing to share management talent and expertise opt for a partnership or a company structure with several shareholders.

■ Finance

Initially the business owner may not be able to afford the expenses associated with setting up and operating a company and opt for a less expensive structure such as a sole trader. However, as a sole trader access to finance is limited to your own resources. As the business develops and its need for finance grows other structures may be more appropriate. A partnership has greater access to finances from the resources of all the partners but has a problem of unlimited liability. Under a company structure it is easier to attract finance because the personal assets of shareholders cannot be touched to pay for the debts of the company (limited liability). In addition, a public company can raise vast amounts of capital by selling shares to the wider public.

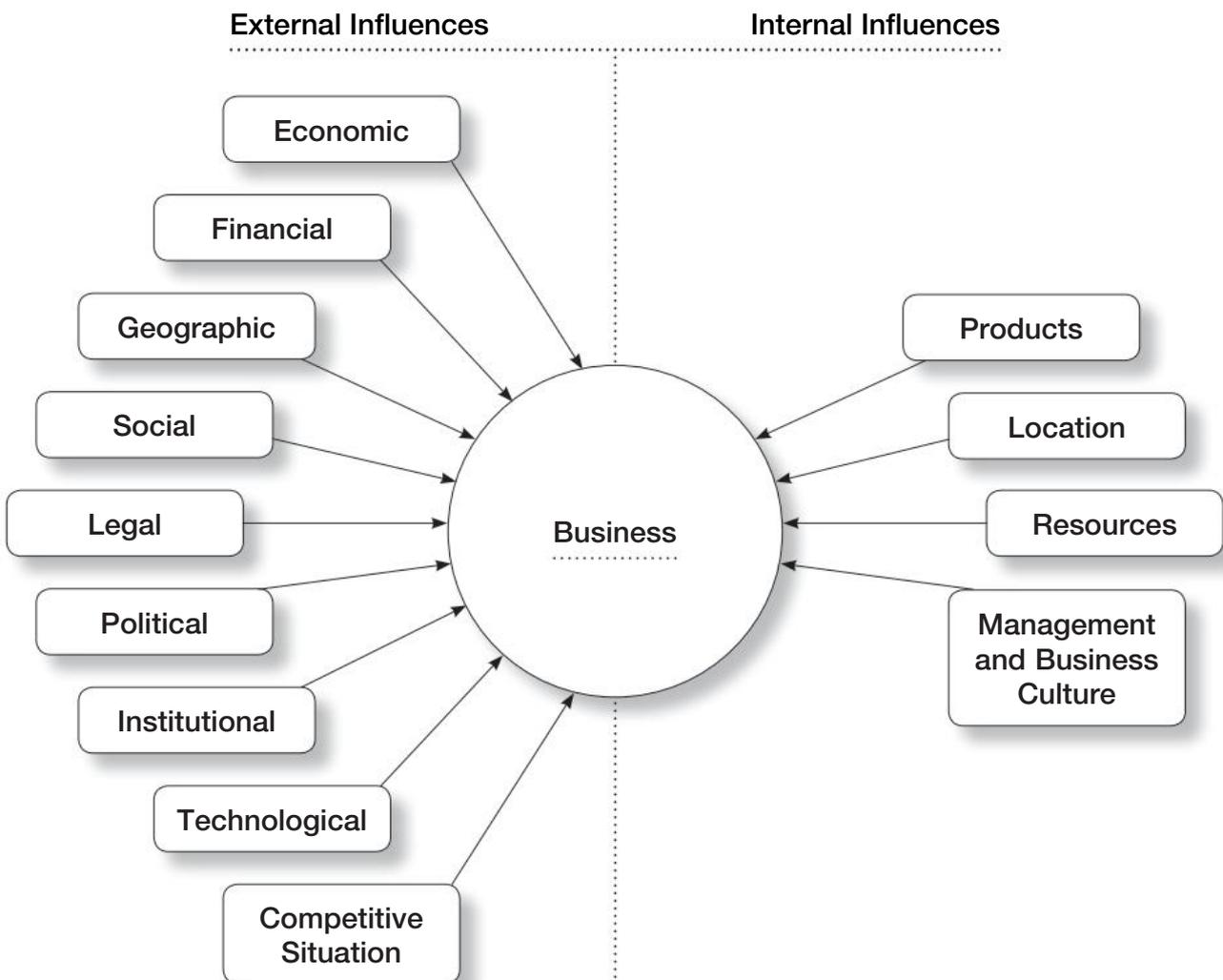
Exercise 1.3

Complete the following table by circling true or false.

	Sole Trader	Partnership	Private Company	Public Company
1. You have full control	True/False	True/False	True/False	True/False
2. It is relatively cheap to set up and simple to administer	True/False	True/False	True/False	True/False
3. Gives you protection from personal liability	True/False	True/False	True/False	True/False
4. Easy to raise capital	True/False	True/False	True/False	True/False
5. Transferring ownership is easy	True/False	True/False	True/False	True/False

2. Influences in the Business Environment

Figure 1 External and Internal Influences



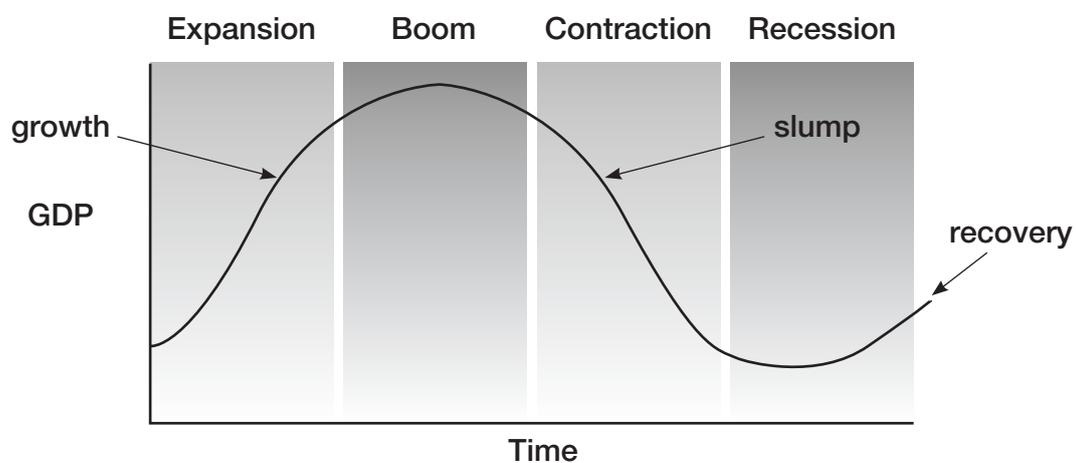
a) External Influences

A business does not operate in a vacuum. They must deal with an ever-changing environment in which they operate. Businesses must act and react to what happens outside the factory and office walls. The range of factors that can influence the operation and performance of a business outside the business' control are known as external influences.

■ Economic

Changes in overall economic conditions have a big influence on business. Economic growth rates have an underlying tendency to rise and fall in regular cycles. The cyclical pattern is called the economic cycle (See Figure 2 below)

Figure 2 Economic Cycle



An expansion is characterised by an increase in positive economic indicators such as GDP, employment, income, output, wages, profits, demand, and supply of goods and services. The economy is growing, consumers' confidence is high, and consumers feel safe to borrow and spend leading to increased profits and investment for business. A boom or peak is the highest point of the business cycle, when the economy is producing at maximum allowable output.

Following a peak, the economy typically enters a correction which is characterised by a contraction in GDP growth and the economy slows down. Demand and investment decreases because consumers and businesses become uncertain about the future. Employment declines (unemployment increases), and business profits fall. A severe downturn is called a recession defined by 2 successive quarters of negative economic growth. The slowing ceases at the trough and at this point the economy has hit rock bottom from which the next stage of recovery will emerge.

Some businesses are more vulnerable than others during an economic downturn. These tend to be businesses where purchasers can easily put off their spending because it is discretionary (non-essential). For example, hotels, construction, high end restaurants, airlines and new cars.

Case Study COVID-19 Economic Recession

The COVID-19 pandemic has triggered a severe economic recession in Australia, the first time since 1991. Though this one is a lot more severe. COVID-19 has seen half of Australian business in financial trouble as businesses are either shut down or restricted due to efforts to contain the virus. Two-thirds of Australian businesses have reported decreases in revenue and accessed support packages like wage subsidies, rent or lease arrangements and deferred loan repayments. Many businesses have also deferred investment plans. Businesses have had to make changes to their workforce with many standing down workers, making them redundant and reducing their work hours. The unemployment rate is expected to rise to 10% but would have been much higher if it were not for the Government's Job Keeper Program.

Governments use various policies to try to smooth out the economic cycle (reduce the big ups and downs). These include:

Monetary Policy: Where the Australian Government uses the Reserve Bank to influence the level of interest rates to help manage and control the economic cycle. When the cycle hits the downturn, a central bank can lower interest rates or implement expansionary monetary policy to boost spending and investment. During an expansion, it can employ contractionary monetary policy by raising interest rates and slowing the flow of credit into the economy to reduce inflationary pressures and the need for a market correction.

Fiscal Policy: Where the Australian Government adjusts its spending levels and tax rates to help manage and control the economic cycle. To end a recession, the government can employ expansionary fiscal policy, which involves deficit spending. Conversely, it can use contractionary fiscal policy to stop the economy from overheating during expansions, by taxing and running a budget surplus to reduce spending.

■ Financial

Financial factors include exchange rates and interest rates. These factors greatly affect how businesses operate and make decisions and are often linked to the economic cycle. Economic downturns are often followed by falls in exchange rates and interest rates.

Interest rates affect a business's cost of capital and therefore to what extent a business grows and expands. Businesses with debts have higher costs because they must pay more interest. Also, consumers with debt will have less income to spend because they are paying more interest to lenders.

Exchange rates can affect the costs of exporting goods and the supply and price of imported goods for business. A depreciation will make exports cheaper and exporting business will benefit. However, firms importing raw materials will face higher costs of imports. An appreciation makes exports more expensive and reduces the competitiveness of exporting businesses. However, firms importing will face lower costs of imports.

■ Geographic

Australia's unique geographical location within the Asia-Pacific region has a big impact on business activity in Australia. The Asia-Pacific region is expected to continue to enjoy the highest growth rates in the world. China is Australia's biggest trading partner mainly due to China's strong demand for iron ore, coal and liquefied natural gas. Many major Australian mining companies rely heavily on China and other growing big economies such as India for exports. Already over 70% of all Australian exports are to this region.

The demography (features of the population such as size, age, sex and cultural background) also has a significant influence on Australian businesses. Changes in any of these factors can lead to changes in demand levels and the nature of products and services. Australians today are older, have fewer children, are more likely to live in urban areas, and are more likely to be born overseas.

■ Social

Social influences refer to the factors in society which alter consumer trends and spending habits. Changes in tastes, fashions and cultural values affects businesses in how they are run and the sales, profit opportunities, and business growth they will achieve. Businesses must respond to what their consumers want. A business will lose customers if it does not keep up with current social trends.

Changes in social influences presents both threats and opportunities for a business. For example, consumers are now more health conscious which is deeply affecting manufacturers and distributes of fast/sugary or processed foods. KFC changed its name from Kentucky Fried Chicken because the word 'fried' connotated unhealthy fatty food. Coca Cola Amatil has diversified into beer (Canadian Club and Miller beer) and coffee (Grinders) as consumers are becoming more aware of health risks associated with sugar consumption.

Also, consumers are far more environmentally aware and desire to minimise their carbon footprint. Grocery chain Harris Farm has discontinued single-use plastic bags at registers across all its stores. Who Gives a Crap make 100% recycled toilet paper, use no plastic packaging and they donate 50% of profits to build toilets in the developing world. Their caption is good for your bum, great for the world!

■ Legal

The Australian Government establishes many rules and regulations that guide businesses. Regulatory laws are standards that affect how businesses operate in specific situations. Businesses must comply with regulations established by federal, state and local governments. Failure may mean heavy financial penalties as well as damages to their brand. If an organisation trades globally this becomes especially tricky since each country has its own set of rules and regulations.

Federal Government	State Government	Local Government
Taxation requirements of businesses (GST, PAYG, Company tax and FBT), Registration requirements such as TFN and ABN, Consumer protection (Competition and Consumer Act), Fair Work Act (National workplace relations system), Unfair dismissal legislation, Compulsory superannuation.	Taxation requirements of businesses (Payroll tax), Work Health and Safety, Workers compensation, Anti-Discrimination Act, Environmental protection	Zoning (land use), Development applications, Health, fire and parking regulations

■ Political

These determine the extent to which government and government policy may impact on a business. Major political change can lead to business uncertainty or business confidence. As governments at all levels in Australia regularly face elections, there is an element of politics in most major issues that affect the business environment.

The NSW State Government introduced controversial lockout laws in response to a spate of alcohol-fuelled violence. The legislation required 1.30am lockouts and 3am last drinks at bars, pubs and clubs in the Sydney CBD entertainment precinct. Many of the clubs, bars and restaurants are having trouble attracting customers because of the restrictions the laws place on their commercial premises.

Political factors include government stability as well as trade, fiscal and taxation policies. In recent years the Australian Government has vigorously pursued trade liberalisation policies. Australia currently has ten Free Trade Agreements (FTAs) with 16 countries with more under negotiation. These FTAs contain legally binding commitments by each member to liberalise access to their markets for goods and services as well as investment. Trade liberalisation has impacted on Australian businesses by improving market access for Australian exporters in global markets.

Case Study COVID-19 Government Restrictions

Government's (both Federal and State) mandated restrictions to business operations to protect the Australian community from the spread of the virus. These were most severe in Victoria which had a much greater number of cases. These restrictions included hygiene protocols, border restrictions, restrictions on public gatherings, physical distancing (1 person per 4 square meter rule), allowing employees to work from home and the need to prepare a COVID-19 Safety Plan. These restrictions particularly impacted businesses like restaurants, bars, night clubs, gyms, cinemas, and music festivals. The Government (particularly Federal) have provided financial assistance to businesses impacted by COVID-19 through Job Keeper payments, providing a mandatory code of conduct for commercial renters and cash flow support to businesses that employ staff.

■ Institutional

There are several external institutions that influence the business environment.

1. Environmental Protection Agency (EPA): environmental regulator to reduce pollution and waste, protect human health, and prevent degradation of the environment.
2. Australian Taxation Office (ATO): government statutory which collects revenue (GST, Company tax etc) for the Australian government and enforces taxation law.
3. Australian Securities and Investments Commission (ASIC): corporate regulator which enforces and regulates company and financial services laws to protect Australian consumers, investors and creditors.
4. Australian Competition and Consumers Commission (ACCC): independent Commonwealth statutory authority which enforce the Competition and Consumer Act 2010 and promotes competition.
5. Australian Securities Commission (ASX): regulates public companies and oversees the operation of the Australian share market.
6. Trade Unions: organisations of workers that seek through collective bargaining with employers to protect and improve the real incomes, working conditions and job security of their members.

■ Technological

Technology provides opportunities for businesses to adopt new breakthroughs, innovations, and inventions to cut costs and develop new products. Innovations in technology such as changes in digital or mobile technology, automation, research and development, new methods of distribution, manufacturing and logistics affect the operations of the business. It has increased the need for more highly skilled labour, eliminated boring and repetitive jobs and created an emphasis on training and development of staff.

For example, Qantas' new computerised technologies for online booking, online ticketing and online check-in have eliminated the need for staff to interface the customer reducing labour costs. New planes like the Dreamliner use less fuel and provide a better experience for passengers (quieter and better in-flight entertainment) making travel more comfortable. New digital technology allows Qantas to target specific demographics and interact directly with their customers, which makes them feel closer to the business improving brand loyalty.

■ Competitive situation

All businesses face competition, regardless of the market in which they operate. Some markets are highly competitive, while others have significantly less competition. The competitive situation depends on the number of competitors a business faces, the relative size of competitors and the ease with which a business can enter the market.

Globalisation and the growth in e-commerce has led to increased competition. Apple now faces fierce competition from a multitude of rivals from around the globe, all vying for a slice of the lucrative premium smartphone market. These include Samsung and China's Huawei, which overtook the iPhone maker to become the second largest smartphone manufacturer

by volume in the world. The new amazon.com.au has brought a lot more competition for Australian retailers. Amazon offers a wide range of products from local and international manufacturers, many products at a lower price than other retail stores and ecommerce sites as well as free shipping with super quick delivery.

Competitors will try to win market share by cutting costs, improving efficiency, lowering price and innovating by either creating new products and services or improving upon old ones. In order to guarantee its longevity in the market, a business must continually develop strategies to counteract the activities of competitors.

Qantas launched its own low-cost airline Jetstar to counter Virgin's emergence in Australia. Woolworths and Coles have responded to increased competition from Aldi by investing heavily in data analytics to crunch data they collect through loyalty schemes, apps and online shopping to make their marketing and promotions more effective.

b) Internal Influences

Internal influences originate from within the business itself and are within the control of the business. Managers can often determine the success or failure of a business through decisions to make a certain product, locate a business or the type of resources they will use in the business.

■ Products

The most important influence from the internal environment is the good the business is producing or the service it is delivering. A number of businesses will be competing to produce a product that meets the needs of its customers better than its competitors. The product may be more competitive because it is better quality, or in the opinion of the customer offers better value for money or possibly provides better customer service. Managers need to be aware of all the things that contribute to the overall customer need and develop a product that meets that need.

■ Location

Location has a strong influence on the success of many businesses despite the rise of technology, virtual communication and cloud businesses. Basically, you just want to be wherever your customers are and make it as convenient as possible to visit you. Location is of utmost importance especially to businesses that sell goods or services directly to customers. A business's location is also an important factor in the way that business is perceived, access to suppliers and ability to recruit and keep great staff.

■ Resources

The manager of a business also has control over the resources needed to conduct the operations of the business. Resources refer to things like finance, employees (human resources), equipment (shop fit out, technology) and raw materials. The way the resources are acquired and used will affect things like the quality and value for money of the product and directly impact on the competitiveness of the product.

■ Management and Business Culture

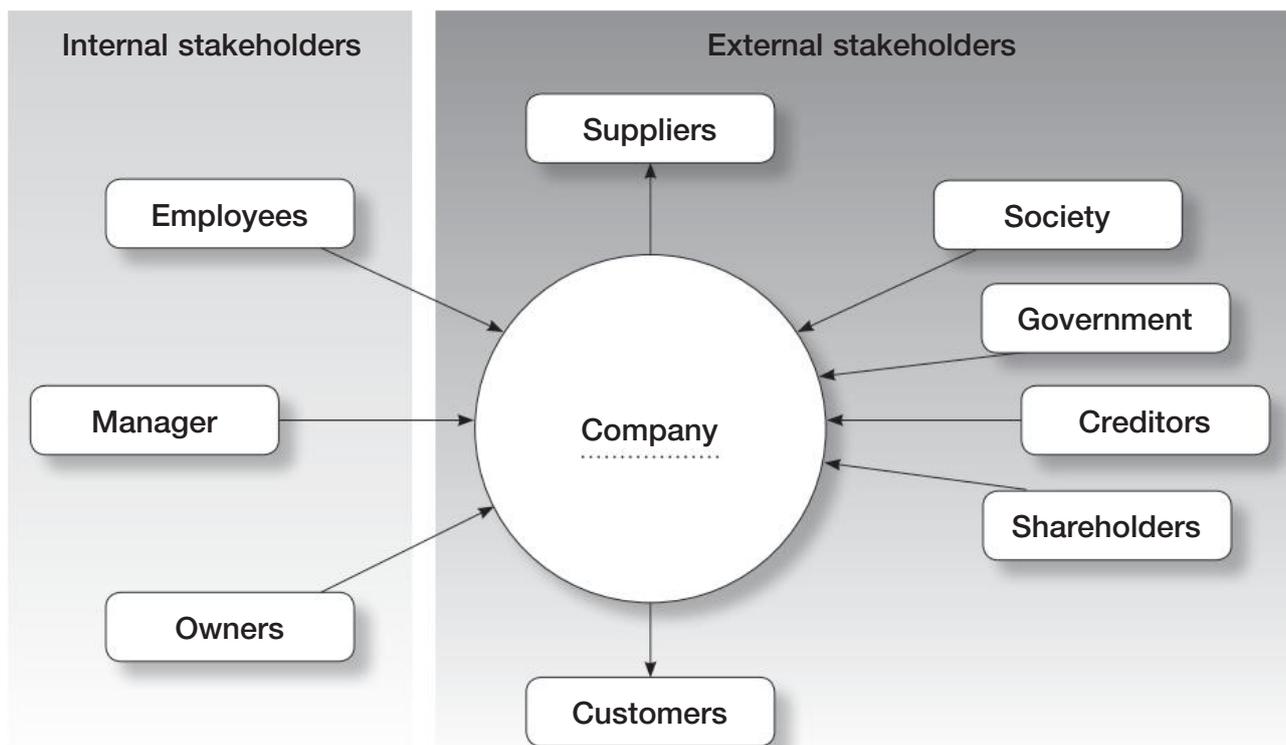
Management and business culture refer to the attitudes and values of the managers and employees within the business. There is an important relationship between the way things are done in a business and business success. A business culture needs to be based on 'best practice' rather than the way things may have been done in the past. Best practice refers to the way the most competitive businesses in the industry do things and clearly involves ideas such as efficiency, quality production, and high levels of customer service. Failure to adopt ideas like these may lead to a gradual loss of customers as they switch to businesses that better meet their needs.

Management has a responsibility to demonstrate the beliefs of the business and reinforce behaviours that reflect those values. Managers need to make clear expectations when employees are first introduced to the business and reinforce those expectations through training and rewards. Management and business culture can determine success or failure during times of change: Mergers, acquisitions, growth, and product cycles can either succeed or fail depending on the alignment of culture with the business's direction.

c) Stakeholders

Stakeholders are a person or group that can affect or be affected by the actions of a business. Stakeholders have a 'stake' in the business and can gain or lose as a result of business activity. Stakeholder interests may conflict and effective management of relationships between the business and their stakeholders is key to businesses operating effectively. Stakeholders can be divided into internal (inside the business) and external (outside the business).

Figure 3 Stakeholders



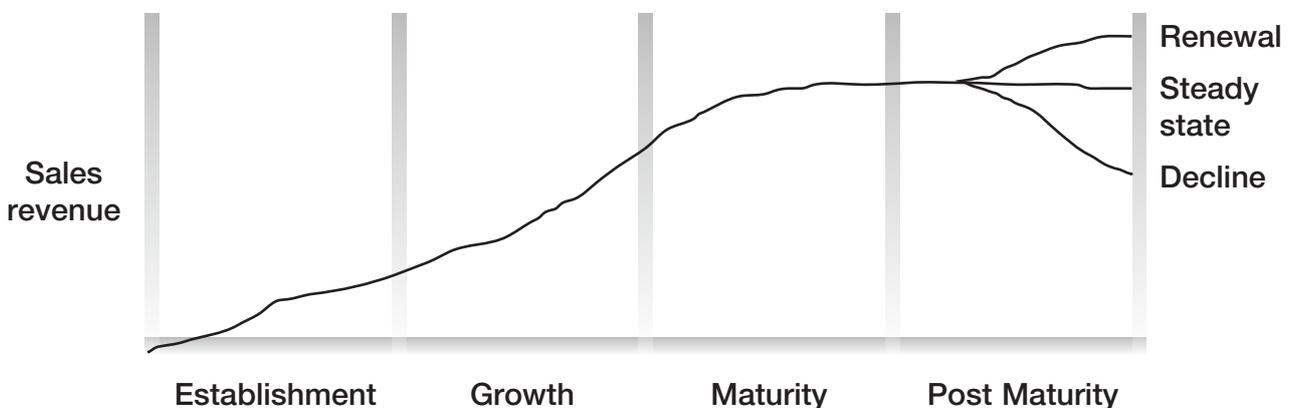
4. Business Growth and Decline

a) Stages of the Business Life Cycle and Responding to the Challenges of each Stage

The business life cycle refers to the stages a business goes through during its lifetime. There are 4 recognised stages in the business life cycle – establishment, growth, maturity and post maturity. However, not every business will go through every stage. Each stage has distinct characteristics. These stages are illustrated in Figure 4.

A business goes through stages of development like the life cycle of a human being. As a human matures, they will require different amounts of resources through the stages of its lifecycle. Understanding the different stages of the business lifecycle will help enable businesses to successfully meet the challenges they may face.

Figure 4 The Business Life Cycle



■ Establishment

The establishment stage describes the start-up phase for a new business. It's like the kick-off and the first few minutes to a football or netball game. In State of Origin this is known as the softening up period and this term also fits well with the establishment stage. Many things can go wrong at this stage, detailed planning is crucial.

- The characteristics of a business in the establishment stage are:
 - Slow growth in sales because there is a lack of customer awareness
 - Initial profits are small (and could be losses)
 - High initial start-up costs often result in negative cash flow
 - High risk of business failure

The challenges for businesses in the establishment stage are:

- Survival and setting a solid foundation for growth by generating energy, innovation and plain hard work
- Managing cash reserves, low sales and unexpected expenses which cause a drain on limited financial resources

- Obtaining finance from financial institutions because it is likely you have underestimated your financial needs
- Finding good employees and implementing new staffing procedures
- Implementing low cost and appropriate marketing strategies that establish a customer base and market presence

■ Growth

Once a business survives its establishment stage it then moves on to the growth stage. Sales and customers are increasing with many new opportunities, but it is not without its fair share of challenges which require effective management.

The characteristics of a business in the growth stage are:

- Sharp increase in sales because of greater customer awareness
- Profits are strong
- Cash flow becomes positive
- Opportunities to achieve cost sales by operating on a larger scale (economies of scale)
- Major investments in more staff and resources to support the increase in sales volume
- Improved product range and a wider distribution
- Business risk decreases while the ability to raise debt increases

The challenges for businesses in the growth stage are:

- Expanding too fast and losing control of the business's direction
- Ensuring that the quality of the product or service is maintained as sales grow
- Recruiting new staff and delegating responsibilities
- Implementing better accounting and management systems
- Managing cash flow and the financial requirements of expanding the business
- Dealing with increasing market competition

Case Study Afterpay



The Australian technology-driven payments company launched in 2015 processed more than \$21 billion of sales through the Afterpay platform in 2021, a 90% increase on the previous 12 months. The platform is used by about 98,000 retailers and over sixteen million total active customers in 2021 growing at an average of 3600 a day.

Afterpay have recently raised \$300 million from investors to support its international growth plants in the UK and US. The service allows shoppers to purchase their items in-store or online and then pay for them over four instalments every 2 weeks. Afterpay allows shoppers to bypass the hassle of applying for a loan or credit card before purchasing an item. There's no interest or added fees and no waiting like a layby.

Afterpay is about to face some stiff competition with Visa launching its own payment scheme in 2020. Also, in light of the Banking Royal Commission Afterpay is facing new government regulations to protect at-risk customers.

■ Maturity

Eventually the rapid growth in sales evens out and the business enters the maturity stage. The business is well known in the market, with loyal customers and a high volume of repeat business. There are still challenges to meet and decisions to make.

The characteristics of a business in the maturity stage are:

- Sales level off (plateau) because there is a lot more competition
- Profit margins get thinner
- Strong cash position
- High level of brand recognition
- Business is stable enough to survive most unforeseen circumstances
- Greater emphasis on product differentiation (creating subtle differences in your products/services) to distinguish them from your competitors
- Greater focus on efficiency (cost cutting) to maintain high profit levels because it is harder to increase sales

The challenges for businesses in the maturity stage are:

- Staying responsive to consumer demand and identifying opportunities for innovation
- Adapting to a changing business environment
- Motivating staff and avoiding complacency
- Financing the replacement and updating of technology and equipment
- Effectively implementing strategies to reduce costs like outsourcing, strategic alliances and restructuring.
- Balancing the conflicting objectives of stakeholders

Case Study Dymocks

Dymocks is Australia's leading bookstore chain employing 800 staff across 60 stores. They have just celebrated their 140th birthday.

Dymocks has had to evolve to meet customer needs in a very competitive marketplace. To maintain sales Dymocks has added non-book products such as cards and journals and built an online Booklover customer loyalty program. Customers are segmented on their purchase history, age and reading preferences and then sent targeted email offers. The company has just established a tutoring business called Potentia offering tutoring in English, maths, physics, chemistry, biology, economics, legal studies and business studies.



■ Post-maturity

This is the final stage of the business life cycle. After the maturity stage a business a business can remain in steady state, decline or renew.

The characteristics of a business in the post maturity stage are

- Renewal: new areas of growth cause increased sales and profits
- Steady State: business continues to operate at the same level as maturity and maintains its position
- Decline: profits and sales begin to fall

The challenges for businesses in the post maturity stage are:

- Increased competition and changing consumer preferences create a need for change
- Improve the competitive position of the business through cost cutting
- Create a culture of change
- Innovating your product or service and invest in new employees, technology or processes.
- Manage legal processes and responsibilities ethically and legally

Case Study Darrell Lea

One of Australia's oldest confectionery companies Darrell Lea's strategy changed significantly after it nearly collapsed in 2012. Darrell Lea closed all its stores nationwide and massively expanded the number of retailers who sold the company's products to include supermarkets, David Jones, Big W and Australia Post.



Darrell Lea sought new areas of growth by creating an ice cream and chocolate block version of some of their most iconic confectionery items like peanut brittle and Rocklea Road as well as expanding into muffins with partner Muffin Break. They have also just bought the Life Savers lollies brand, first created in 1912, back from Swiss food powerhouse Nestle and has taken over Heritage Fine Chocolates in Victoria to increase its manufacturing capabilities. The renewal of the business had seen its revenue surge to \$50 million in 2020.

Exercise 1.4 True or False

Indicate whether the following statements are true or false.

True/False Questions	True/False
1. All businesses will experience every stage of the BLC	
2. Each stage of the BLC has its own special features and challenges	
3. Business planning should be adjusted to the relevant stage of the BLC	
4. Cash flow is often negative in the establishment phase because of high start-up costs	
5. Businesses in the growth stage seek capital to expand	
6. In the growth stage revenue is steady and predictable	
7. Businesses have the easiest access to capital in the maturity phase	
8. The main risk in the maturity stage is the failure to adapt to a changing environment	
9. Renewal is a continued state of maturity	
10. Decline is difficult to reverse if products have become obsolete	

b) Factors that Contribute to Business Decline

About 55000 Australian businesses go bust each year.

Small businesses are most vulnerable with more than 60% closing within the first 3 years. This figure escalated due to the impact of COVID-10. The impact on Australian businesses is unprecedented with many businesses facing major hits to revenue and cash flow with the demand for goods and services considerably reduced. Many businesses have been forced to pause trading altogether. The biggest impacts have been on the airline, hospitality, retail and tourism industries.

Business failure is not usually caused by just one single factor but rather a combination of several. About 70% of businesses primarily fail due to a lack of management expertise such as insufficient business planning, excessive borrowings, undercapitalisation, failing to keep proper financial records, poor human resource management or inadequate marketing (failure to meet customer needs). The other 30% of businesses fail due to changes in the external environment (unforeseen occurrences) such as a COVID-19 downturn in economic activity, a change in government policies or a new competitor.

Exercise 1.5 Matching

Match the following recent business failures with the correct businesses below:

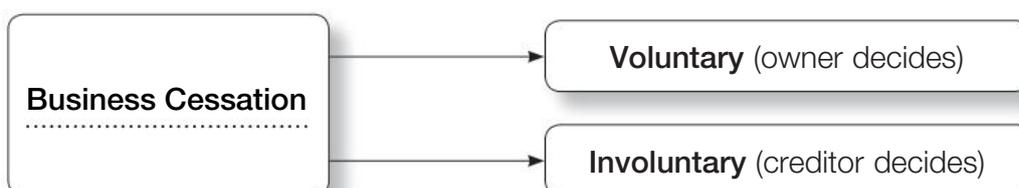
1. International book and music retailer who closed its doors in 2011.	
2. Video rental retailer who shut down all its stores in 2013.	
3. Children's clothing retailer who closed its 100 stores and went into voluntary administration in 2017. Bought by the Catch Group and has returned as an online store only.	
4. Luxury handbag and fashion accessories retailer who entered voluntary administration in 2017.	
5. Toy retailer who closed in 2018 because of tough trading conditions and competition from retailers like Amazon.	
6. Technology company that used to dominate the photographic film market. Cameras went digital, disappeared into cell phones and people went from printing pictures to sharing them online.	
7. Menswear chain which closed its 57 stores in 2018 after no buyers emerged. Failed to cope with the influx of international competition and evolution of online shopping.	
8. Homewares and clothing retail chain went into administration again in 2018. Administrators failed to find a buyer to save the chain from collapse.	
9. International clothing retailer who closed all its 67 Australian stores in 2018.	
10. Chocolate retailer and café chain which collapsed in 2018.	

Word Bank: Roger David, Max Brenner, Pumpkin Patch, Kodak, Laura Ashley, Toys R Us, Borders, Blockbuster, Esprit, Orotan.

c) Voluntary and involuntary cessation

Cessation is when a business closes and stops trading. A business may cease operations voluntarily or involuntarily. The difference between the two depends on who instigates the process.

Figure 5 Business Cessation



A business may cease operations by voluntarily winding up its affairs. This means that cessation is the owner's choice. This is due to conditions within the business owners' power like the owner may wish to retire, wants a change of lifestyle or the business is sold, and ownership is transferred to the buyer.

Most businesses however finish involuntarily. This normally occurs when a company is unable to pay its debts due to circumstances beyond the business owner's control like unfavourable economic conditions and increased competition. The owner is forced to cease trading by the creditors of the business who initiate legal action. The Australian Government regulates the closure of businesses through the Bankruptcy Act and Corporations Law.

The cessation process depends on the legal structure of the business.

With Sole traders and partnerships (unincorporated businesses) the owners are personally responsible for the debts accrued by the business. If the business is unable to pay its debts the individuals may be declared bankrupt either voluntarily filing for bankruptcy or involuntarily through creditors applying for you to become bankrupt. When you become bankrupt, you are declared by law to be unable to pay your debts. A registered bankruptcy trustee takes control of most of your finances to dispose of personal assets to repay your debts. Bankruptcy lasts for three years. During this time, you will have limits on what you can do, such as restrictions on running companies and work in certain professions. Bankruptcy is recorded on your credit report for up to seven years and on the National Personal Insolvency Index permanently.

Unlike sole traders and partnerships, companies are independent legal entities (incorporated businesses). Different arrangements are used to manage company insolvency (unmanageable debt). There are 3 options: Administration, Receivership and Liquidation. Both liquidation and administration can be voluntary or involuntary, but receivership is initiated by a secured creditor (involuntary).

Administration is where a company's directors' hand over the business to a professional administrator to decide on the best plan of action. The administrator will check the company's books and inform creditors of their findings, and then make recommendations to creditors.

Receivers are usually appointed by a secured creditor (usually a bank) that holds security over some or all of the company's assets. The receiver's appointment is usually subject to the terms of the mortgage over the company's assets. The receiver's key responsibilities are to collect and sell the charged assets in order to repay what's owed to the secured creditor, and then to pay out the money in the order required by law. Their responsibility is to the secured creditor and not to the other parties who are connected to the company, such as other creditors or unsecured creditors. In some cases, the Receivers recover the indebtedness owing to secured creditor and then hands back the business to the directors to continue to trade. In most cases Receivership leads to the sale of business or liquidation.

Liquidation differs from administration and receivership because once a company is in liquidation, it usually means the company will permanently stop trading and cease to exist.

Liquidation is the process in which the legal status of the company is completely terminated. While there are ways back to trading from administration and receivership, liquidation usually means that the liquidator will realise the company's assets and distribute these among creditors pay off creditors in priority order before deregistering the company. Liquidation is the formal process for winding up a company's financial affairs to settle debts with the proceeds of the sales of its assets.

Case Study Max Brenner

Chocolate retailer and cafe chain Max Brenner collapsed into went into voluntary administration in 2018 after the business struggled following an expensive overhaul of its head office and tighter retail trade. Turnover fell to \$41.3 million in 2018 and Max Brenner operated at a net loss of \$5 million for the financial year.



Administrators McGrath Nicol estimated that creditors were owed \$33 million, with major creditors including the ATO owed \$4 million. The company also owes \$1.86 million in superannuation payments and \$2.5 million in GST and pay-as-you-go requirements.

Following a store by store review administrators decided to close 20 of the 37 struggling stores with the remaining profitable stores offered for sale. A rescue deal was struck for Tozer & Co to buy out the business however this deal fell through. After the deal fell through, secured creditor Glenn Wein appointed receivers from Ferrier Hodgson over some of the company's assets. The chain was then bought by United Cinema mogul Roy Mustaca under the Company MB Chocolate.

Exercise 1.6 Multiple Choice

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

1. Which of the following would be defined as a small business?
 - A. An accounting company with 129 employees
 - B. A shoe manufacturing business with 187 employees
 - C. A coal mine with 4500 workers
 - D. A plumbing business with 13 employees
2. Manuel has decided to start his own cleaning business. He aims to service luxury homes in Bryon Bay. In which industry would Manuel be operating?
 - A. Primary
 - B. Secondary
 - C. Quaternary
 - D. Quinary

3. Which of the following legal structures have limited liability?
 - A. Sole Trader and Private Company
 - B. Public Company and Private Company
 - C. Partnership and Sole Trader
 - D. Partnership and Public Company

4. Which of the following statements are characteristics of a sole trader?
 - A. The business has its own legal entity and is subject to company tax
 - B. The operations of the business are generally global in nature and pay high taxes
 - C. The trading name of the business includes the word “Ltd” and it incorporated
 - D. The owner of the business makes all of the decisions and has unlimited liability

5. Under which legal structure are personal conflicts among owners most damaging?
 - A. Companies
 - B. Partnerships
 - C. Sole traders
 - D. Trusts

6. Which of the following is a feature of a public company?
 - A. Perpetual succession
 - B. Unlimited liability
 - C. Difficulty in obtaining finance
 - D. Possibility of partner disputes

7. Which of the following is a characteristic of an upturn in the business cycle?
 - A. Decreasing interest rates and decreased business output
 - B. Decreasing consumer confidence and less spending
 - C. Increasing investment by business and increasing spending by consumers
 - D. Increasing unemployment and increasing spending

8. Australian Taxation Office (ATO), Australian Securities and Investment Commission and the Australian Competition and Consumer Commission (ACCC) are all examples of which type of organisation?
 - A. Government departments
 - B. Business institutions
 - C. Regulatory bodies
 - D. International organisations

9. Which of the following is an internal influence on the business environment?
- A. Location
 - B. Competition
 - C. Economic
 - D. Legal
10. Which of the following best describes the business life cycle?
- A. The fluctuation of economic conditions from boom to recession
 - B. A chart showing the profitability of big business
 - C. The growth stages experienced by a business
 - D. The pattern of consumer boom to consumer recession
11. In which stage of the Business Life Cycle is the priority to develop strategies to maintain customer loyalty and continued purchase of its product.
- A. Growth Stage
 - B. Maturity Stage
 - C. Establishment Stage
 - D. Renewal Stage
12. Which strategy would help a business move from the maturity stage to the renewal stage of the business life cycle?
- A. Increasing debt levels to pay off liabilities
 - B. Reducing the number of products being sold on the market
 - C. Improving their product to cater for changing tastes and preferences
 - D. Decreasing the number of employees to reduce production levels
13. Which of the following is the most common cause of business failure?
- A. Poor products
 - B. Economic conditions
 - C. Vigorous competition
 - D. Poor management
14. Which of the following best represents a creditor?
- A. An internal stakeholder of the business
 - B. A shareholder of the business
 - C. A business to whom money is owed
 - D. A business who owes money to another business

15. Which of the following best represents the liquidation process for a business?
- A. The assets of the business are sold and distributed to creditors
 - B. A declaration that the business cannot pay its debts
 - C. Creditors trade the business out of its problems
 - D. The business is forced to stop trading

Exercise 1.8 (10 marks)

Chelsea and Emily both are ex-students of Sydney College – class of 2015. Both have completed tertiary studies, Chelsea in Business and Emily in Communications. They are about to start their own wine bar in Narrabeen on Sydney’s northern beaches.

- a) Identify TWO ways that business can be classified. (2 marks)

- b) Describe TWO factors that may influence Chelsea’s and Emily’s choice of legal structure. (2 marks)

- c) Outline ONE characteristic and ONE challenge of businesses in the establishment stage of the Business Life Cycle. (2 marks)

- d) Explain how TWO external factors would affect the operations of Chelsea's and Emily's wine bar.

(4 marks)

Exercise 1.9 (10 marks)

Hackett Pools Pty Ltd has been struggling for several years. The business was wound up by its creditors in February 2022. Prior to this the business employed 10 staff.

- a) Identify TWO factors that can contribute to business decline.

(2 marks)

- b) Outline TWO roles of businesses like Hackett Pools Pty Ltd.

(2 marks)

c) Distinguish between voluntary and involuntary business cessation in a business. (2 marks)

d) Analyse TWO problems that may arise for stakeholders of Hackett Pools Pty Ltd when the company goes into liquidation. (4 marks)

Answers to Exercises

Exercise 1.1

1. Primary, 2. Secondary, 3. Quinary, 4. Quaternary, 5. Quinary, 6. Quaternary, 7. Tertiary, 8. Primary, 9. Secondary, 10. Primary

Exercise 1.2

1. Director, 2. ASX, 3. Shareholder, 4. Perpetual Succession, 5. ASIC, 6. Sole Trader, 7. ABN, 8. Partnership Agreement, 9. Unlimited liability, 10. Public Company

Exercise 1.3

1. T, F, F (unless there is only 1 shareholder), F
2. T, T, F, F
3. F, F, T, T
4. F, F, T, T
5. F, F, F, T

Exercise 1.4

1. F, 2. T, 3. T, 4. T, 5. T, 6. F, 7. T, 8. T, 9. F, 10. T

Exercise 1.5

1. Borders, 2. Blockbuster, 3. Pumpkin Patch, 4. Orotan, 5. Toys R Us, 6. Kodak, 7. Roger David, 8. Laura Ashley, 9. Esprit, 10. Max Brenner

Exercise 1.6

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

Exercise 1.7

- a) Answers could include size, geographical spread, legal structure, industry type
- b) Answers could include size, ownership, finance
- c) Answers could include characteristics (low sales, low profits, could be losses, high start-up costs, not well known), challenges (cash flow, securing more finance, finding good staff)

Sample Answer: The establishment stage describes the start-up phase for Chloe and Emily's new business. One characteristic is the slow growth in sales because there is a lack of customer awareness. One challenge is managing cash reserves, low sales and unexpected expenses which cause a drain on limited financial resources and may result in cash flow problems.

- d) Answers could include economic, social, legal, competitive situation, political, technological

Sample Answer: Changes in economic conditions with impact the business. The effect of an economic slowdown would be decreased consumer confidence, decreased spending and business profits would fall. The effect of an expanding economy would be increased consumer confidence, increased spending and business profits would rise. Legal influences would also have a big influence on this business. The effect is that the business will have to abide by government laws and regulations such as taxation, work health and safety and workers compensation or face fines and damages to their reputation.

Exercise 1.8

- a) Answers could include poor management, ineffective marketing, changes in external environment like more competition, recession etc
- b) Answers could include provide employment, provide goods and services, choice, innovation

Sample Answer: Businesses like HP provide choice to consumers. When HP competes, they provide more options for customers who get the best possible prices. They also provide innovation creating better products, ideas and processes benefiting consumers with new and better products.

- c) Answers could include voluntary – owners decide, involuntary – creditor decides

Sample Answer: A business may cease operations by voluntarily winding up its affairs (the owner's choice) due to conditions within the business owners' power like the owner may wish to retire, wants a change of lifestyle or business is sold. Involuntary cessation occurs when a company is unable to pay its debts and the owner is forced to cease trading by the creditors of the business who initiate legal action.

- d) Answers could include employees, owners, shareholders, customers, suppliers, creditors, government etc

Sample Answer: When HP is wound up there are implications for employees. They will be without a job and their may be concerns for their accrued entitlements such as holiday pay and long service leave. There are also implications for their suppliers who will lose sales and profits. There may also be outstanding debts that may not be recovered.

Chapter 2

Business Management

1. Nature of management

Businesses are complex organisations that are made up of people and processes.

- Businesses produce goods and/or services with the goal of making a profit.
- Businesses do not run on their own, they are led and coordinated by people.
- The process of “running” a business is called **management** and the people who conduct this process are called **managers**.

If a business is managed well, it will achieve its goals such as increased sales or profits. If a business is managed poorly, it can lose customers or sales, and may ultimately fail.

a) Features of effective management

A manager is someone who leads and runs a business.

A small business might have one manager who is also the owner. A larger business might have many managers. If you have a part-time job after school you would have a manager – they might also be known as “your boss”.

All businesses have one senior manager who takes ultimate responsibility. This person may sometimes have a specific title such as Chief Executive Officer or Managing Director. In a large business, this senior manager will be assisted by a group secondary managers. Together, these managers make up what is referred to as the Senior Management Team.

There are literally thousands of different types of businesses in Australia, producing millions of different goods and services. Everything from cereal, shoes, computers and sofas – to plumbing services, banking products, fitness gyms and phone plans.

Because businesses are so varied and complex, when we discuss them we often use general models to describe what they do and how they operate. One of these models, which outlines the features of effective management, is called POLC – which stands for Planning, Organising, Leading and Controlling.

The POLC model can be seen in the table below. Each term in the model is explained and supported by an example of what this might look like at a small café.

Table: POLC – Features of Effective Management

Management Feature	Explanation	Small Cafe
Planning	Setting goals and objectives for the business	Introduce a new menu item (smashed avocado on toast) to increase sales
Organising	Working out the steps needed to achieve the business goals	<ul style="list-style-type: none"> ■ Liaise with suppliers to order avocados and sourdough bread ■ Calculate pricing of new item ■ Update printed menus in cafe
Leading	Communicating, directing and motivating staff in order to achieve the business goals	<ul style="list-style-type: none"> ■ Train chef on how to cook new menu item ■ Instruct wait staff to inform customers of new menu item
Controlling	Monitoring the business to see if it achieved its goals – and making changes if necessary	<ul style="list-style-type: none"> ■ Monitor sales of new menu item ■ If sales are poor, modify recipe or pricing

b) Skills of management

A manager must have a variety of skills in order to be effective in their role.

The skills required by managers have changed over time. Back when the Australian economy was focussed on the production of goods in factories, managers had to possess skills that would make them effective in running a business that produced things like cars or fridges. However, modern managers must possess skills relevant for service industries, such as banking, information technology, hospitality or tourism.

Some skills required by managers are more practical, such as organising rosters. Other skills are related to managing and motivating people, which are sometimes known as “people skills” or “soft skills”.

There is no such thing as the ‘perfect manager’ with the “perfect set of skills”. In the same way that you might be good at particular subjects at school, a manager might be good at particular management skills.

Let’s imagine the report card for two successful managers, Lyndsay and Nathan. Both are excellent managers and have a report card average of 85%. However, as you can see below, they vary in their competence across a range of different management skills.

Management Report Card [each skill is graded from 1-10]		
Management Skill	Lyndsay	Nathan
Interpersonal	9/10	6/10
Communication	10/10	7/10
Strategic thinking	10/10	10/10
Vision	9/10	9/10
Problem-solving	7/10	10/10
Decision making	9/10	9/10
Flexibility	6/10	10/10
Adaptability to change	7/10	9/10
Reconciling the conflicting interests of stakeholders	10/10	7/10
Average	85%	85%

There are various skills of management.

■ Interpersonal

Interpersonal skills relate to how well you interact with other people.

Managers who have strong interpersonal skills are well respected by their employees and are able to motivate their staff through their personality. These skills are particularly important in modern, service-based businesses, where people are central to business success.

Managers with strong interpersonal skills have the following qualities:

Leadership	The ability to motivate people and get them to follow the plans and actions of the business
Empathy	Being able to genuinely listen to staff and understand their needs and desires
Likability	A certain style of personality that is able to get on with people from a variety of backgrounds.
Accountability	The trait of taking responsibility for your actions and not blaming others for your failings
Courage	Willing to do challenging things, face situations that may involve conflict, or stand up for what you believe in

Your school captain is likely to have strong interpersonal skills.

■ Communication

Managers must be able to communicate effectively in order to instruct and motivate their employees.

Managers need to outline the goals and objectives of the business to staff, and then explain the steps that will need to be taken to achieve these goals.

Management communication must be clear and direct, so that staff are not left confused about what is expected of them.

Managers must also be good listeners. Communication is a “two-way street” and managers need to understand the needs of their staff to ensure they can be successful in their job.

There are two main types of corporate communication:

Verbal	Talking, discussions, negotiations, face-to-face meetings, phone calls, speeches, presentations, media interviews
Written	Emails, documents, memos, reports, notes, instructions, documentation, PowerPoints, blog posts, social media, text messages

As the manager of the classroom, your teacher should have strong communication skills.

■ Strategic thinking

A strategy is a long term plan that affects all key business functions: operations, marketing, finance and human resources.

Managers who are running a business must be able to develop strategic plans which are specific to that business. A strategic plan usually has a timeframe of 3-5 years.

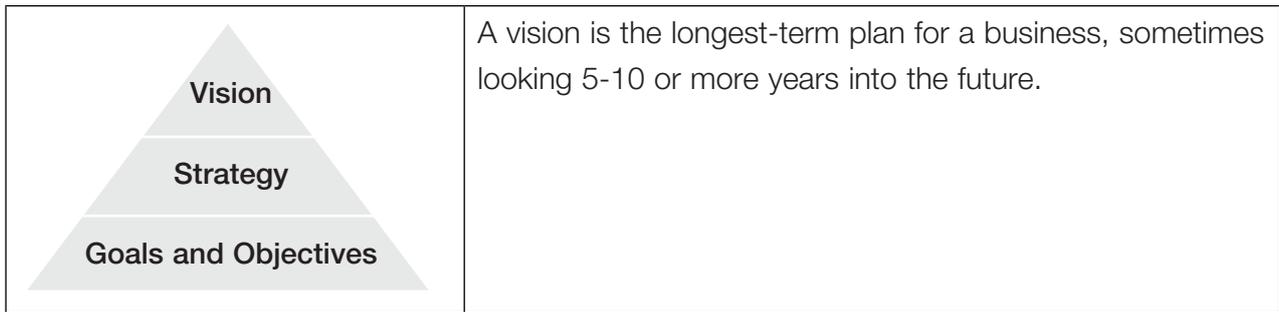
Managers who are good at strategic thinking have the following qualities:

“Helicopter View”	Able to rise above day-to-day business problems to get a sense for where the company should be headed
Business Knowledge	Fully understand all aspects of their business – along with the needs of their customers and the strength and weakness of their competitors
Planning Skills	Can turn the strategy into a series of practical goals and objectives that can be implemented by the business
Selling Ideas	Ability to communicate the strategy to staff in a way that they can understand and get behind

Strategic thinking is a skill that is particularly relevant to senior managers and those that are leading the business.

■ Vision

If you think of business planning as a pyramid, then the vision sits at the top of that pyramid.



If a business does not have a clear vision, then it is difficult to formulate a strategy – or goals and objectives. Often, the vision of a business can be summarised in one short sentence. For example, the vision of Google is to “to organize the world’s information and make it universally accessible and useful.”

Managers who can formulate a vision tend to have the following qualities:

Imaginative	Inventive, creative, insightful and good at “big-picture” thinking
Analytical	Can analyse current business trends and predict future trends
Risk Taker	Ability to make decisions in an uncertain environment
Story teller	Can communicate the vision to staff in simple terms

Once the vision for a business is formulated, it should not be changed very often.

Case Study: Bill Gates – an Information Technology Visionary



When Bill Gates co-founded Microsoft with his partner Paul Allen in 1975, the world of Information Technology (IT) was very different to what it is today. At the time, IT was dominated by IBM and other makers of mainframe computers – huge, centralised devices that were often the size of a small bus. These computers cost millions of dollars each and were only used by specialist professionals in large companies such as banks.

Back then, nobody even dreamt that the average person would ever want or need a computer – but Bill Gates had a different view, and thought that small, “personal computers” were going to be the way of the future. He founded Microsoft with the vision of “a computer on every desk and in every home.” Many business leaders in the IT industry, including IBM, laughed at Bill and thought that his vision was childish and ridiculous – just like the young, 19 year old entrepreneur.

However, it was Bill who had the last laugh. Not only was his vision achieved, but Microsoft went on to become one of the most successful IT companies of all time. Whilst IBM still exists today, Microsoft is now almost 14 times more valuable than its former “big brother”, and has a market capitalisation of around \$US 1.6 trillion.

■ Problem solving

Managers spend a large part of their day solving problems.

Even a small and relatively simple business like a local pizza restaurant could present a manager with dozens of problems to solve in just one shift – for example, what if the chef calls in sick, or the food deliveries did not arrive that day, or the pizza oven breaks down?

Managers sometimes need to involve their staff when solving problems. Staff are often much closer to the situation causing the issue, and have knowledge or insights that are not available to the manager.

If the problem facing a manager is particularly complex or challenging, then it is best for them to come up with multiple solutions. A good manager needs to be able to rank a variety of options and choose the solution best suited to the circumstances.

■ Decision-making

Decision making is closely linked to problem solving. It is usually the final step in solving a problem.

The decisions a manager needs to make can range from minor decisions, such as who to roster on a shift – to major decisions, such as whether to dismiss an underperforming employee.

Different managers vary in their decision making styles. Some will rely on extensive consultation with staff and stakeholders, while others will focus on their own personal judgment and business experience.

A unique feature of management decisions is that they have to be communicated with other people. This could be staff, customers, or other business stakeholders. For this reason, decisions made by managers need to be logical, justifiable and impartial.

Managers want as much information as possible before making a decision, but given the uncertain environments in which businesses operate, this is not always possible. In the case of a crisis, managers will need to make decisions quickly and can be left to rely on their instincts or “gut feel”.

■ Flexibility

The world in which businesses operate is changing at an ever increasing pace.

Businesses need to be able to respond to everything from technological changes, such as the emergence of the Internet – through to social changes, such as the #metoo movement.

Managers cannot be “set in their ways” and must be able to change their plans, decisions and management styles in order to adapt to the ever changing world.

■ Adaptability to change

In order to thrive in an ever-changing business environment, managers must be able to change the business they manage so that it remains competitive.

Manager who are adaptable to change can successfully reinvented their business, whereas those who cannot will lose sales to their more nimble competitors.

Sometimes external technological changes will impact a business whether they like it or not. For example, the increasing popularity of food delivery services such as Uber Eats has forced many small restaurants to completely change the way they interact with their customers.

■ Reconciling the conflicting interests of stakeholders

A stakeholder is any person or group that has an interest in a business.

For a small business like a local florist, stakeholders could include staff, customers, suppliers and family members of the business owner.

For a large business like Qantas, there could be a much broader range of stakeholders. These would include the Qantas Board, shareholders, unions, government and the broader Australian society.

Sometimes the views of different stakeholder groups could be in direct conflict with one another. For example, the Board of a mining company may want the business to open a new coal mine, whereas environmental groups may protest this change. A skilled manager must be able to “juggle” these conflicting interests and ensure that the business never loses sight of its main goal – which is to make a profit.

Case Study: Israel Folau Controversy and Rugby Australia

In April of 2019, prominent rugby union player, Israel Folau, posted a meme to his Instagram account that was judgemental toward several groups in society, including the LGBT community. He claimed he did this from a place of love and that he was simply expressing his deeply held Christian beliefs. However, many members of society saw the situation differently and thought that his views were hateful and deeply homophobic.



The management of Rugby Australia was faced with a very difficult situation whereby there was a divisive conflict amongst its different stakeholder groups. On the one hand, they had one of their star employees who claimed he had done nothing wrong – and on the other, there were large sections of society that found his views hurtful and damaging.

Ultimately Rugby Australia decided to dismiss Israel Folau for this conduct, stating that “as a sport that is proud of the values of inclusion, passion, integrity, discipline, respect and teamwork that underpin our game globally and our Code of Conduct, we will defend those values and the right for all people to feel safe and welcome in our game regardless of their gender, race, background, religion or sexuality.”

Exercise 2.1 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. A person running a business must be fully competent in all the required management skills	
2. Managers must make hard decisions and empathy has no place in the business world	
3. Managers with good communication skills also tend to listen to their staff	
4. The ability to communicate a strategic plan is just as important as the ability to develop the plan	
5. The vision for a business should be changed at least once a year	
6. A good manager can solve problems on their own and does not need input from their staff	
7. When making a decision, a manager must think about how that decision will be justified and communicated to staff	
8. Being flexible in your management style is seen as a sign of weakness in the modern business world	
9. If a manager cannot adapt to change, they will often get left behind by industry changes and overtaken by their competitors.	
10. A large business will normally have more stakeholders than a small business	

c) Achieving business goals

There are six main goals that a business can aim to achieve.

■ Profits

Profit is the primary goal of most businesses. If an organisation does not care about making a profit, then it is unlikely to be classified as a business.

If you have ever run a sausage sizzle fundraiser at school, you would be aware of the concept of profit. You would have generated **revenue** from selling the sausages. But you would also have incurred **expenses** in buying what you needed – such as sausages, bread, onions and sauce.

Profit is simply the money “left over” from your business activities:

$$\text{Profit} = \text{Revenue} - \text{Expenses}$$

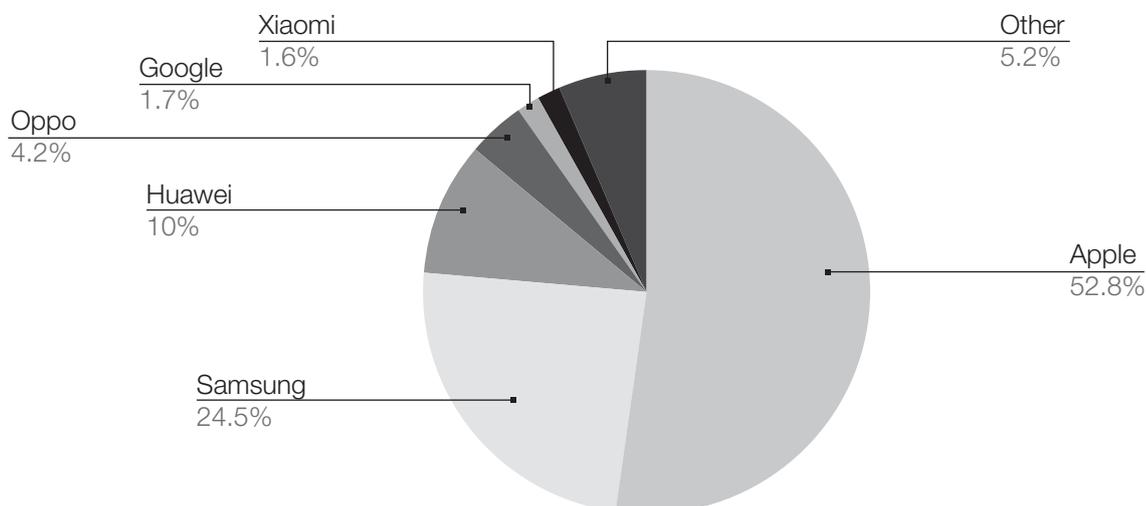
■ Market share

The goal of market share is best represented by a pie-chart, which shows how much market share various businesses control in a certain industry.

If a business’ goal is to win a greater market share, this is usually at the expense of their competitors.

Market share is generally only relevant to large businesses. For example, a local hamburger shop has an insignificant market share of the overall fast food industry in Australia – and hence the measure is not particularly useful to the business. However, for McDonalds, KFC or Hungry Jacks – the goal of market share would be very important.

Fig 6 Mobile Phone Market Share – Australia 2020



■ Growth

The goal of growth relates to increasing revenue.

Growth can be obtained by increasing sales, obtaining new customers, expanding the product range, taking over another business, opening new locations, or entering new markets.

Increased growth can also lead to increased profits, but this is not always the case – especially when a business is first being established.

Case Study: Amazon.com



Online retailer Amazon.com was established in 1994 and its primary goal has always been growth, not profit.

For many of its early years the company made a loss. In fact, it did not report its first profit until 2001 – and even then the figure was relatively insignificant at \$US5 million. Jeff Bezos, the founder of Amazon, justified these losses because he had a long term view of the company. He did not care if the business failed to make profits in the short run, as long as the company was growing and increasing sales in the long run.

This strategy has paid off and Amazon's growth has been phenomenal over the last 25 years. In 2020 the company had US\$280 billion in sales which is greater than the entire GDP of the New Zealand economy. It is estimated that around 40% of all goods sold online in the US are through Amazon.

■ Share price

Share price is only a relevant business goal if a company is publicly owned and has shares traded on the Australian Stock Exchange (ASX).

Some public companies on the ASX are huge businesses that you probably know – such as Woolworths, Qantas, and the Commonwealth Bank.

If the share price for a company is increasing, it is a good indication that the business is well-managed, profitable, and has a bright future. If the share price for a company is decreasing, the opposite is usually the case.

■ Social

The social goals of a business relate to the impact that the organisation has on the wider community. The aim of social goals is to ensure the business is a good “corporate citizen”

Social goals are normally associated with not-for-profit organisations or charities – such as Amnesty International or the Salvation Army. However, increasingly businesses have become concerned with social goals. Qantas has many social goals. For example, the company is a strong supporter of Australian sport, the LGBT community and Indigenous issues.

■ Environmental

Environmental goals relate to the impact that a business has on the world's ecosystems and its use of natural resources.

Qantas has specific and measurable environmental goals. For example, by the year 2030, the business hopes to reduce waste to landfill by 30% and electricity usage by 30%.

Exercise 2.2 Matching

Match the following statements to the correct term in the word bank below:

Statement	Term
1. To achieve this business goal a company should aim to minimise its carbon footprint and the amount of waste it produces	
2. In order to achieve this business goal in the car industry, Toyota would need to take customers away from a competitor like Holden	
3. This business goal is only relevant for public companies that are listed on the ASX.	
4. Companies striving to achieve this business goal aim to be good "corporate citizens"	
5. This is when a business' primary goal is how much money they make	
6. This primary objective of this business goal is to increase sales, even if it is at the expense of profits	

Word Bank: Market Share, Growth, Social, Share Price, Profit, Environmental

■ Achieving a mix of the above goals

Different businesses will want to focus on different goals. While maximising profits is the primary goal of all businesses, the mix of other goals they wish to pursue will vary.

If a business focuses solely on financial goals at the expense of social and environmental goals, they may generate large profits in the short term, but it could harm the business in the long term. This is especially the case for businesses that behave unethically and damage their reputation amongst customers.

Case Study: BP



BP, or British Petroleum, is an oil and gas energy company that was founded in England in 1909. For more than 100 years the business has made huge profits from their sale of petroleum products that are harmful to the environment. Last year alone, the company made a profit of \$US11 billion. BP has also been responsible for several environmental disasters. This includes the Deepwater Horizon oil spill, which occurred in 2010 in the Gulf of Mexico. This spill was the largest ever accidental release of oil into the ocean – an estimated 4.9 million barrels.

Over the last 10 years BP has chosen to acknowledge the negative role it has played in climate change and is attempting to reinvent its business around the “Paris Agreement”. This international treaty calls for the world to rapidly reduce greenhouse gas emissions in the context of sustainable development and eradicating poverty.

■ Staff involvement

Whilst managers may lead a business and set its goals, they will struggle to achieve these goals if they don't have staff involvement – sometimes called staff “buy in”. Staff are critical to business success and if they are not genuinely behind the goals that management have set, they can undermine business success.

Below is a list of four ways in which management can achieve buy-in from staff:

Innovation	Staff are often the best people within a business to come up with new business ideas, products or services. This is because they are the people in the organisation who are “closest” to the customer and thus better understand their wants and needs. Google has an innovation programme called the “20% time scheme”, whereby employees can spend 1 day per week working on any project that interests them. Over the years this programme has been responsible for many new products – examples include Gmail, Google Maps and Google News.
Motivation	Managers who can motivate their staff to achieve business goals will be more successful than those who struggle with this important skill. Staff can be motivated by extrinsic factors: such as pay; working conditions; gifts and bonuses. They can also be motivated by intrinsic factors: such as a sense of accomplishment; meaning from work; praise and encouragement; or a sense of community. A good manager will understand their employees and use an appropriate mix of both extrinsic and intrinsic factors to motivate staff.

Mentoring	Mentoring is when a senior, experienced manager forms a learning relationship with a junior member of staff. Sometimes this mentoring relationship is a way to teach the junior staff member more about the business and how to be more effective in their job. And at other times, specific “high performing” junior staff are chosen for mentoring so that they too can become managers in the future. Mentoring makes staff feel valued and important, and thus more likely to be committed to the business and its goals.
Training	Training takes two main forms. The first is a process called <i>induction</i> , which occurs when an employee first starts their job. At the end of the induction programme, the employee should have thorough knowledge on how to do their job – along with getting to know co-workers, important customers, corporate culture, and Work Health and Safety. Training is an ongoing process throughout the career of an employee, and focuses on acquiring or developing specific skills.

Exercise 2.3 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. Mentoring is appropriate for all staff and managers	
2. Induction usually only happens once, when an employee starts with a business	
3. A motivated workforce can lead to increased business profits	
4. Training only happens once in the worklife of an employee	
5. Staff should be involved in setting business goals because they know the customer well	
6. Profit is the only goal that matters for a business, even if it damages the reputation of a company	

2. Management approaches

You have probably encountered many different types of managers in your life – whether it be at work, at school, or on the sporting field.

The way that a coach would “manage” a team of U17 boys playing rugby league, would be very different to the way a coach would manage a girls U6 soccer team. This same principle is relevant in the world of business. For example, the methods and techniques used to successfully manage a cement factory would be quite different to those that would be successful in managing a small graphic design business.

Similarly, the way that a coach might have managed a sporting team when your grandparents were young, is probably very different from the methods that would be used today. Again, the same goes for business – management approaches have evolved throughout history. The approaches that were successful 150 years ago in a factory that produced steel, are quite different to modern approaches suited to a service economy that relies on people and innovation.

The following sections will explore these ideas further. We will learn how management approaches have changed over time to adapt to changing business environments.

a) Classical approach

The classical approach to management evolved out of the Industrial Revolution that started in England in the 1750s.

The Industrial Revolution saw goods being “mass produced” under standard conditions in huge factories. Prior to the industrial revolution a single artisan might be able to produce a few shirts in one day, whereas an industrial factory could produce several thousand and at a much cheaper cost.

One of the earliest pioneers that formalised the classical approach into an academic theory was Frederick Taylor, who summarised his ideas in the book *The Principles of Scientific Management* (1911). In this book he argued that the scientific principles of observation and experimentation should be applied to the workplace to maximise efficiency and the output of goods and services.

The classical approach focussed on the idea that there was “one best way” to do any task – whether that task was to assemble a car or make a pair of shoes. This ideal process could only be discovered through observation and experimentation, and once it was finalised and documented, it was the job of a manager to train all workers on the process and ensure it is implemented consistently across the factory.

■ Management as planning, organising and controlling

Those who follow the classical approach believe that managers perform three key functions: planning, organising and controlling.

Planning

There is a famous saying in business – “people don’t plan to fail, they fail to plan”. Managers must plan all aspects of a business’ operations. Suppose that you want to open a factory producing cars. Here are just some of the questions you might need to think about when managing this project:

- How many cars will be produced?
- How many models or variations will be produced?

- How will the cars be produced – by people or by robots?
- How big will the factory be?
- Where will the factory be built?
- How much will the project cost?
- How many staff will be needed and what skills must they have?

The list is virtually endless, but a good manager needs to prepare for all possibilities. In conducting the planning process, a manager needs to look at all the tasks that need to be completed, and categorise them according to three different timelines. These can be seen below:

Plan Type	Timeframe	Features	Example (car industry)
Strategic planning	4 to 5+ years	Long term plans that affect all areas of the business	Reinvent the business around environmental goals; develop completely new products like cranes and tractors
Operational Planning	1 to 3 years	Medium term plans that affect specific areas of the business	Develop a new model of car; open a new factory; buy another car company
Tactical Planning	Less than 12 months	Short term plans that affect the day-to-day running of the business	Set a monthly car production target; hire new workers in the factory; create a new advertising promotion

Organising

Once management has decided on a plan of action and timeframes, they need to **organise** workers to ensure that products are produced as efficiently as possible. In conducting this process, a manager will look at the following questions:

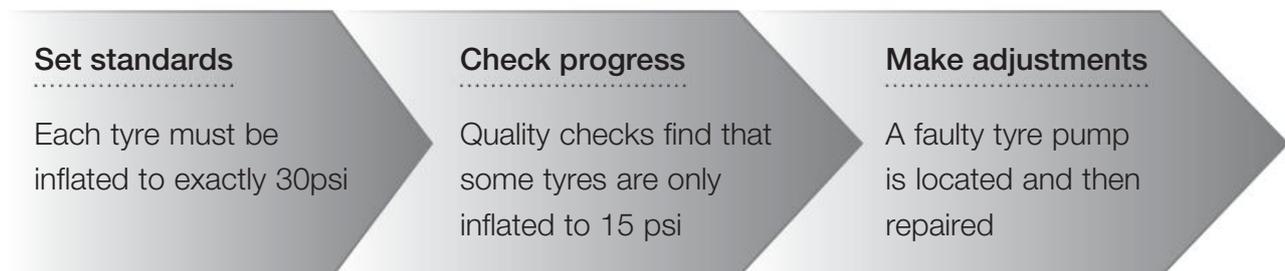
How will each job be done?	Each job is broken down into a series of steps. Management experiment with each step until they find the most efficient process for each job possible – whether that job be riveting the chassis together, fitting wheels, installing electricals, or doing a final spray paint.
How will people work together?	Workers who have the same skills and do similar tasks in the factory will be grouped together. Workers also need to be ordered correctly to produce the good – for example, workers riveting the chassis together will be at the beginning of the process, and those doing the spray paint will be at the end.

Who will be responsible?	Different levels of responsibility need to be given to each worker. Some are responsible for just their job in producing the car, some are responsible for a small team, and others are responsible for the entire factory.
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Controlling

The third key function of managers following the classical approach is called controlling. This involves ensuring that goods are made correctly and according to certain quality standards. If problems are discovered, solutions must be found and then implemented into the production process.

An example of controlling can be seen below in the flowchart below:



Case Study: Roses Only

Roses Only is an Australian online florist that specialises in the sale of roses as gifts for special occasions. The business was established in the 1990s by the father and son team of Peter and James Stevens. It started as a “bricks and mortar” store, but went fully online in 1999. Over the years the business has expanded into other product lines, including *Hampers Only*, *Wine Only* and *Fruit Only*.



Managers at *Roses Only* must apply the management principles of planning, organising and controlling to ensure that their business operates efficiently. Because much of their product range is fresh and will spoil quickly, they must methodically plan out their daily orders, arrangements and deliveries. This ensures that stock is rotated quickly. As a business specialising in gifts, it is essential that their customers remain 100% satisfied, as negative online reviews could have a disastrous effect on the business.

■ Hierarchical organisational structure

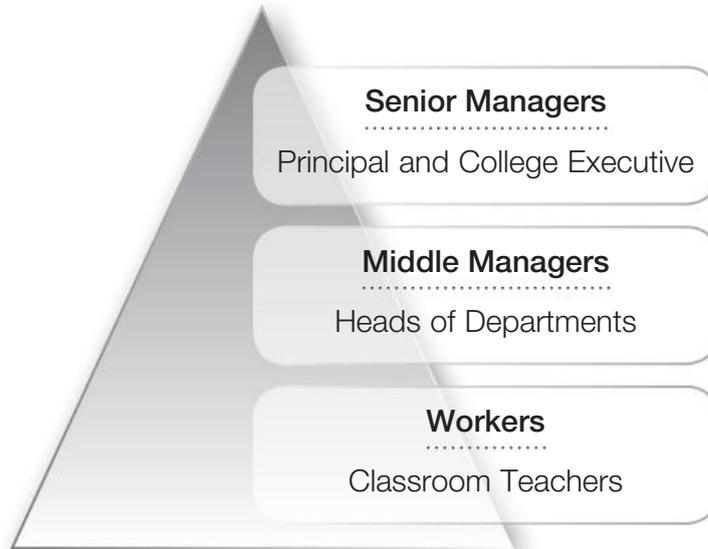
The classical approach organises its workforce according to a hierarchical organisational structure that resembles a pyramid.

There are a small number of senior managers at the top of the pyramid. They are responsible for setting the direction of the business and making all the key decisions.

Below them are a larger group of “middle managers”. Their job is to ensure that the plans, goals and objectives of the senior managers are implemented.

At the bottom of the pyramid are the workers. They make up the largest group of people in the business, and are the ones who are responsible for doing the actual work to produce goods and services.

Many high schools have a hierarchical organisational structure, as seen in the diagram below:



■ **Autocratic leadership style**

Managers following the classical approach often adopt an **autocratic leadership style**.

This method of management is based on the idea that the leader of the business has all the answers, and knows the best way that the business should be run.

Managers who are autocratic follow the motto – “It’s my way or the highway.”

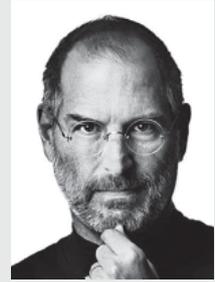
A summary of the autocratic style can be seen below:

Features	Advantages	Disadvantages
<ul style="list-style-type: none"> ■ Clear line of authority ■ Managers have all the power ■ Managers make all key decisions ■ Employees follow instructions ■ Structured and clearly defined workplace 	<ul style="list-style-type: none"> ■ Works effectively for certain types of businesses ■ If leaders are competent it can be successful ■ There is no uncertainty or ambiguity in the workplace 	<ul style="list-style-type: none"> ■ Inappropriate in many modern workplaces ■ Staff can be disengaged and only do the bare minimum ■ Little innovation – especially from staff ■ Incompetent managers can lead the company to financial ruin

The autocratic leadership style is still commonly used in the following types of businesses: fast food restaurants; supermarkets; trades and construction.

Case Study: Steve Jobs

Steve Jobs founded Apple computers in his garage in 1977. Many in the media praised Jobs as a charismatic and visionary leader who must be “the perfect boss” to work for. However, since his death in 2011, many Apple workers have revealed that nothing could be further from the truth. By all accounts he was demanding, pedantic and inflexible. He had a short temper and was well known for yelling at staff and belittling them.



Jobs was very much an autocratic leader. Even he was aware of this, as can be seen from this interview with a newspaper in 2008: ““My job is to not be easy on people. My job is to make them better. My job is to pull things together from different parts of the company and clear the way to get resources for key projects. I need to take these great people we have and to push them and make them even better, coming up with more aggressive visions of how it could be.”

Exercise 2.4 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. Operational planning has a timeframe of 1-3 years	
2. Autocratic leaders have staff feedback as one of their main priorities	
3. To be successful, all modern managers should adopt an autocratic leadership style	
4. The classical approach to management is closely linked to the industrial revolution	
5. The key activities for managers following the classical approach are planning, organising and controlling	
6. Management styles have changed little throughout history	
7. The classical approach organises its workforce in the shape of a pyramid	

b) Behavioural approach

The behavioural approach to management evolved during the 1920s and was centred on the idea that the most important aspect of any business is its people.

A manager following the behavioural approach is most concerned about how to motivate their workers. Followers of the approach believe that people are not just motivated to work by money, fear, or social status. Instead, work becomes its own reward and gives people meaning and direction to their lives. In particular, people are most engaged when they are working together in teams.

■ Management as leading, motivating, communicating

Those who follow the behavioural approach believe that managers perform three key functions: leading, motivating and communicating.

Leading

A behavioural manager leads by example and inspires their workforce to follow them.

They are empathetic – meaning they understand other people, and what motivates and drives their behaviour. They respect their workforce and are good at listening to other perspectives on the business.

They are flexible in their decision making process and often consult workers to obtain their feedback. This builds trust and consensus throughout the business so that everyone feels they are “on the same team”.

Whilst a behavioural managers must sometimes make decisions that are unpopular, the relationships they have built over time will at least ensure that everyone feels they have been treated as fairly and equitably as possible.

Motivating

When motivating their employees, a behavioural manager focuses on intrinsic motivation – which are factors within each individual that inspire them to succeed. Different employees are motivated by different things.

Recognition is important to some staff and they thrive on praise that comes from being complimented on a job well done. Other staff might be more motivated by the sense of self worth they obtain from employment, and the feeling of importance they get in making a positive contribution to society.

A successful behavioural manager will have the skills to determine the individual motivating factor for each of their employees, and adjust their management style accordingly.

Communicating

Because a behavioural manager aims to lead by example, it is essential that they are excellent communicators.

Communication for a behavioural manager is a two-way process. They must be able to communicate the vision, goals and objectives of the business to employees – as well as be able to listen to employees to obtain their feedback and achieve consensus.

■ Teams

Central to the behavioural approach to management is the concept of work teams – a group of people working toward a common goal or objective.

Teams work best in businesses that are trying to solve difficult problems and achieve complex goals. They are often comprised of between 6-12 employees who all have different roles, but work together closely and know each other well.

For example, a team at an IT software company might work together with the objective of developing a new product feature. Some members of the team might work on the design features, some on the “look and feel” of the product, and others on software testing. But they are all working on the same product and have the same goal.

Managers of teams are often called “team leaders”. They are usually informal in their management approach, and focussed on learning what motivates their staff to achieve their best.

A work team is very similar to a sporting team – everyone has a specific role, but they are working together to try and win a game. As the saying goes, *there is no “I” in team*.

■ Participative/democratic leadership style

Behavioural managers adopt a leadership style called ***participative/democratic***.

This leadership style should not be confused with the term democracy – it does not mean that employees get to vote on all decisions.

However, employee feedback is central to the leadership style. There is an acknowledgement by managers that they are not expert or “all-knowing” when it comes to the business, and they need to rely on their staff for information so that they can make the best decision possible.

Treating staff in this manner makes them feel valued and respected. This increases their involvement and motivation – and ultimately improves their performance and contribution to the goals of the business.

Case Study – Atlassian Software

Atlassian is an Australian software company based in Sydney. It was founded by Mike Cannon-Brookes and Scott Farquhar in 2002. The company has grown exponentially in its relatively short history – it has over 5,000 employees and revenues of over \$1.6 billion. Since its earliest days, the founders of the business adopted a behavioural approach to management, but with an unconventional twist.

Atlassian lists its five core company values on their website. Three of these values are relatively common in the corporate world:

- *Build with heart and balance*
- *Play, as a team*
- *Be the change you seek*

But two of the values are very unique and irreverent:

- *Open company, no bull#@!%*
- *Don't #@!% the customer*

Atlassian aims to attract top employees to its business through its informal and unpretentious management style. Scott Farquhar once stated in a newspaper interview that he wants “to ruin employees so they never want to work anywhere else...and rue the day they left Atlassian”



c) Contingency approach

The contingency approach to management is based on the idea that there is no “one best way” to manage any business. The approach you should take depends on the circumstances.

■ Adapting to changing circumstances

The contingency approach is based on the idea of flexibility.

In the modern business world, things are always changing. As such, a manager must never to be “stuck in their ways” of doing things. Even within the same types of businesses, different management approaches are often needed.

For example, imagine we have a successful airline. The behavioural approach might be the best choice in managing this business. Staff in this airline presumably know what they are doing – so a good manager would adopt a participative/democratic leadership style, and work with employees collaboratively with the goal of making things even better.

However, suppose we have another airline who are performing poorly and are on the verge of bankruptcy. For this business, the classical approach might be more effective, and a manager

might need to adopt an autocratic leadership style. This would allow the manager to set a new direction for the business from the top, and ensure that employees follow instructions to turn the business around.

A skilled contingency manager will know how to modify their management approach depending on the business, situation and environment.

Exercise 2.5 Matching

Match the following statements to the correct term in the word bank below:

Statement	Term
1. The process whereby a manager listens to their staff and values their input	
2. These workgroups are essential to the behavioural approach	
3. Praise given to staff in order to motivate them	
4. A management approach based on flexibility and adapting to changing circumstances	
5. The leadership style adopted by behavioural managers	
6. A trait that allows behavioural managers to understand people and what motivates their behaviour	

Word Bank: Participative/democratic, Feedback, Empathy, Teams, Recognition, Contingency

3. Management process

All businesses perform the same main process – they sell a product or service in the hope of making a profit. In Business Studies we break down this main process into a group of sub-processes, called the Key Business Functions (KBFs). These are outlined below:

Key Business Functions (KBFs)

Operations	Manufacturing a product or delivering a service
Marketing	Selling the product or service – which involves developing the features, setting the price, distribution and promotion.
Finance	Tracking money coming in and out of the business to determine if it is making a profit
Human Resources	Hiring, training and managing the employees of the business

Managers must understand all the KBFs of a business if they are to manage it successfully.

a) Coordinating key business functions and resources

A good manager will understand the KBFs in their business, but more importantly, they will understand how the KBFs interact. This interaction of the KBFs is known as **interdependence**.

There is a saying that “a chain is only as strong as its weakest link” – and the same goes for businesses. There is no point in having an excellent Marketing function and a weak Operations function, as the two functions depend on one another. In fact, each of the four KBFs depend on all the others.

Case Study – The Apple Store

Whilst Apple computers was founded in 1977, they did not open their first signature Apple Store until 2001. The stores were an instant success, during a period when most traditional “bricks and mortar” retailers were in decline. There are now over 500 Apple Stores in 27 countries around the world.



The Apple Store is an example of a business where all their KBFs work together perfectly and are strongly interdependent. This interdependence is visible to any customer who enters the store.

- **Marketing** – The entire Apple product range is on display throughout their stores. Customers can see the products and are encouraged to interact and use them.
- **Operations** – When launching a new product such as the latest iPhone, customers are able to pre-order their product then pick it up instore. Literally thousands of customers are able to get the same product, on the same day – anywhere in the world.
- **Human Resources** – All staff in the Apple Store are motivated and have exceptional customer service skills. The stores also pioneered the concept of the “Genius Bar”, whereby highly trained specialist staff are able to assist customers with all their issues and technical questions.
- **Finance** – Opening a new Apple Store costs millions of dollars. They are often located in the most expensive locations that require huge rents. Apple is able to afford all this because of the high profitability of their business.

The seamless interdependence of all the KBFs at the Apple Store has contributed to it becoming one of the most successful, and valuable companies in the world.

b) Operations

Operations is the business function concerned with manufacturing a product or delivering a service.

In managing the Operations function, businesses often try to reach a balance between quality and cost.

At one extreme a business can produce a good that is of exceptional quality, but this will increase the cost of production. At the other extreme they can produce a good at a very low cost, but it will likely be of poor quality.

A skilled operations manager will know how to get the quality/cost balance right for their particular business and circumstances.

■ Goods and/or services

The end result of the operations process is the production of a good or service. The key elements of these two outputs can be seen below:

	Goods	Services
Definition	Tangible object – you can physically hold the item in your hand	Intangible – an activity performed for you by someone else
Production	Often the production process has little human intervention – goods usually made in factories by machines	Service is delivered by people, who are often highly skilled – customer service is critical to the product
Examples	Can of Coke, iPhone, car, pen, hair brush, coffee cup, shoes, watch, umbrella	Haircut, tutoring, lawn mowing, plumbing, financial advice, legal services

Not all products fit perfectly into the category of goods or services. Sometimes there is a great deal of overlap.

A pizza restaurant is both a good and a service. The business does produce a tangible good – the physical pizza. But there is also a large service element to the business – whether it be the pizza chef, the clerk taking your order, or the delivery driver. Both elements of the good and service are equally important for this business. Customers want a tasty and satisfying pizza, but they also want polite service and fast delivery.

■ The production process

When a business manufactures a product or delivers a service, they follow three distinct steps. These steps are known as the production process. The production process is comprised of three elements: Inputs; Transformation Processes; and Outputs.

The Production Process



Further details on each element of the production process can be seen in the table below:

Element	Key Features	Example – Manufacturing a car
Inputs	Resources used to make the product. They include natural resources, raw materials, people, machines, and knowledge.	Raw materials such as sheet metal, engine parts, glass, rubber, plastics, electrical components, leather – along with a factory, workers and robotics.
Transformation Processes	The steps involved to make the product.	A factory “assembly line”, where each part of the car is put together in a particular order. Some of this will be done by robotics, and some will be done by people.
Outputs	The final product – for a good it is tangible, for a service it is intangible.	The finished car that is driven out of the factory and sent to the car dealership for sale to the customer.

Every business, no matter how large or small, has a production process.

Sometimes the production process is simple and easy to identify, such as for a factory making chairs. At other times, the production process can be hard to analyse or describe. This is especially in the case of complex service businesses such as a legal firm, financial institution or insurance company.

Case Study: Pizza Hut



Started in the USA in 1958 by brothers Frank and Dan Carney, Pizza Hut grew quickly to become the largest pizza chain in the world. It currently has 12,000 stores around the world, with 270 in Australia. Almost all the Australian stores focus solely on the home delivery model.

In order to get a piping hot pizza delivered to you on time, Pizza Hut must have world-class operations in its kitchens and delivery systems. Customers can order online and are given an estimated time of arrival (ETA) on their pizza when they complete their order. This ETA target is usually achieved within a few minutes. In recent years, Pizza Hut has had to modify its operations processes to cater for new food delivery platforms such as Uber Eats. This has involved extensive modification to its IT infrastructure and delivery systems to ensure it is still able to meet its ETAs and ensure customers remain satisfied with its products and service.

■ Quality management

When a customer buys a new product, their expectation is that it “just works”. We have very little tolerance for faulty products that do not satisfy our needs. Businesses aim to meet this customer expectation for faultless products through a process known as **quality management**.

There are three levels of quality management:

Quality Control	This level is the minimum level of quality management that any business should implement. It involves processes such as checking or inspecting goods at each stage of production. The aim is that no faulty goods leave the factory.
Quality Assurance	This is the next level of quality management and involves a more proactive approach. Rather than just looking for faults, the business implements quality systems that are considered “best practice” in its industry. The aim is that the business produces goods that are at least the same quality as its competitors, if not better.
Total Quality Management (TQM)	This is the highest level of quality management. TQM puts quality at the centre of the organisation, with each employee in the business being responsible for quality in some way. Quality is seen as the main competitive advantage of the business.

Each level of quality management builds on the previous one. Whilst all businesses would like to aim for Total Quality Management, this needs to be balanced against the cost of implementing such strict quality management processes.

Exercise 2.6 Matching

Match the following statements to the correct term in the word bank below:

Statement	Term
1. Items such as raw materials that are needed at the beginning of the production process	
2. The process by which a good is made or a service is delivered	
3. The minimum level of quality management that should be implemented by any business	
4. The key business function concerned with manufacturing a good or delivering a service	
5. An item for sale that is tangible – you can touch and feel it	
6. The interaction of the four key business functions	

Word Bank: Interdependence, Operations, Good, Production Process, Inputs; Control

c) Marketing

Marketing involves the processes around selling a good or service.

A marketing manager must perform several roles in the selling process. These include developing the product features and setting the price – as well as promoting the product and distributing it to customers.

■ Identification of the target market

One of the key goals of marketing is to develop a good or service that customers actually want.

The business environment is extremely competitive and if a company does not clearly understand the wants and needs of their customers, then they are setting themselves up for failure.

Very few products appeal to all people in society. Even very large businesses like Coke or Apple do not sell their products to every person in society. For example, Coke would not sell soft drinks to babies, and Apple would unlikely sell many iPhones to people aged over 90.

To better understand the wants and needs of their customers, businesses conduct **market research**. This can take the form of interviews, questionnaires, focus groups and product samples. It can also include online research and social media analysis.

Businesses use a processes called **market segmentation** to categorise all potential customers into smaller groups. These groups share common characteristics that may be relevant to the product a business is selling.

Some of the common characteristics that businesses use to segment markets can be seen in the table below:

Characteristic	Explanation	Example
Geographic	Where the customers live	Country, state, region, suburb
Demographic	Features of individual customers	Age, gender, education, income
Psychographic	Internal characteristics of customers	Personality, lifestyle, interests, motivations

A **target market** is a group of customers who share common characteristics.

Businesses identify target markets so they can market their product to customers who are most likely to purchase their good or service – and not waste effort or resources on segments or customers who are unlikely to purchase.

For example, a target market for Chanel perfume might be older women, who live in wealthy suburbs, and are motivated by social status. It would be inefficient for Chanel to target men

who live in the country and enjoy fishing – thus the business would ignore this segment in their marketing efforts.

Case Study: Coca Cola



Coca Cola is an American soft drink business that began operating in Australia in 1938. Everyone is familiar with their flagship product – Coca Cola – along with its sugar free variations of Diet Coke and Coke Zero. But over the years Coke has expanded well beyond this range, with each of its products catering to a specific target market. You may be aware that Coke also owns brands such as Fanta, Sprite and Lift – but did you know that Coke also owns all of the following:

- Powerade
- Bisleri
- Cascade
- Keri Juices
- Pump
- Mount Franklin
- Fuze Tea
- Appletiser
- Glaceau Vitamin Water
- Barista Bros.
- Zico coconut water
- NutriBoost

■ Marketing mix

Once a business has identified its target market, it must then develop specific **marketing strategies**. These are long term plans on how it will sell its product to a specific target market.

A key element of the marketing strategy is the concept of the **marketing mix** – also known as the “Four Ps” – Product, Price, Place and Promotion.

A marketing manager must customise each of the “Four Ps” so that they satisfy the needs of their customers. This process is not an exact science and can take lots of experimentation to get “just right”.

Each component of the marketing mix can be seen in the table below:

Product	Characteristics of the good or service – such as colour, size, brand, logo, features, packaging, label, warranty.
Price	The price must be set so that the business is able to make a profit. The prices that competitors charge must also be taken into consideration.
Place	The product must be distributed – which is the process of how it reaches the customer. Options for distribution might include selling via a retail store, or directly to the public through the internet
Promotion	This includes any activity to make customers aware of the product and want to buy it. Examples include advertising, sales promotions, publicity, product placement and social media.

Below are some examples of the marketing mix for the Apple iPhone. When reading through this list, consider how it might differ for Apple’s competitors, e.g. Samsung or Huawei.

Product	Price	Place	Promotion
<ul style="list-style-type: none"> ■ Design “look and feel” ■ Technical specifications ■ Features – Siri, iTunes Store, App Store 	<ul style="list-style-type: none"> ■ Premium Price ■ Expensive in relation to competitors ■ Never put on sale or discounted 	<ul style="list-style-type: none"> ■ Apple Store – retail ■ Apple Store – online ■ Retailers– e.g. JB HiFi ■ Phone companies – e.g. Telstra 	<ul style="list-style-type: none"> ■ TV Ads ■ Online advertising ■ Product placement in TV shows and Movies ■ Social media influencers

Exercise 2.7 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. Age and gender are not relevant when segmenting markets	
2. Market research and market segmentation are both used to identify a target market	
3. The marketing mix for all bottled water should be same as each business is selling the same product	
4. A target market is a group of customers who share common characteristics	
5. The marketing function sets the price for a product	
6. The four elements of the marketing mix are product, price, professionalism and promotion	
7. Some products appeal to everyone and don't need to focus on a target market	

d) Finance

Finance involves tracking money coming in and out of the business to determine if it is making a profit.

Profit is the “reason for being” of all businesses. All business activities are either directly or indirectly conducted with the goal of making a profit. Whilst a business can have many secondary objectives – such as corporate social responsibility, social justice, or care for the environment – if a business is not making a profit it will soon cease to exist.

A key activity for Finance is to source money through borrowing for the business. Almost all businesses will at some point need to borrow money in the form of loans. These loans may be needed to establish the business, expand the business, or to keep the business running in times of financial difficulty.

Finance plays a unique role in terms of interdependence and how it relates to every other KBF within the business. Operations could not buy inputs, factories, machines or equipment if it were not for Finance. Marketing could not carry out research, develop new products, establish distribution channels, or conduct advertising campaigns if it were not for Finance. Human Resources could not hire, train or pay its employees if it were not for Finance.

Finance plays a key role in **accounting** – which is a management process that tracks the flow of money used by the business. The business must be “held to account” for every dollar it spends and receives. It is the job of the Finance Manager to keep a detailed record of this money flow – which are also known as **financial transactions**. Money can flow into the business from customers, around the business in the process of making products, and out of the business to pay suppliers.

The financial information tracked and recorded by Finance is often too detailed to use in business planning. To make the data more “user friendly”, Finance generates three key summary reports – known as **financial statements**. These are used by senior management to run the business.

A summary of the key financial statements can be seen below:

Cash Flow Statement	Shows whether a business can pay its bills on time
Income Statement	Shows whether a business is making a profit
Balance Sheet	Shows what a business is worth

The following sections will go into more detail on each of these financial statements.

■ Cash flow statement

A cash flow statement shows whether a business can pay its bills on time. The statement tracks the flow of cash in and out of the business over a period of time. By cash, we mean bank notes, coins and money held in business bank accounts.

If a business is unable to pay its debt on time, it risks becoming insolvent. This means that the business will no longer be able to trade and will be shut down.

The central purpose of cash flow statements is to manage the timing of payments. Sometimes a business has cash owing to it from customers, but has not received this cash in time to pay its own bills – this is called a cash flow problem.

You might sometimes have cash flow problems with your own personal finances. For example, suppose it is 23rd October and you have just run out of credit on your mobile phone. You have

worked two shifts this week at your part-time job, however you will not receive your pay until 25th October. But you need the money now! In essence, you have a problem with timing – a cash flow problem!

There are two main types of transactions that are recorded in a cash flow statement, inflows and outflows. Details on these transactions can be seen below:

	Definition	Examples for a Cafe
Inflows	Cash payments coming into the business	<ul style="list-style-type: none"> ■ Revenue from selling coffee and food
Outflows	Cash payments going out of the business	<ul style="list-style-type: none"> ■ Paying suppliers for coffee beans, milk, cups, sugar, etc. ■ Paying staff ■ Paying bills such as electricity and rent

When the finance manager is planning the year ahead, they estimate the various inflows and outflows that will impact the business over the next 12 months. This is called a cash flow forecast.

A cash flow forecast will never be 100% accurate, but it is the businesses “best guess” on inflows and outflows over the next 12 months.

A cash flow forecast is similar to a weather forecast, in that both are trying to predict something uncertain in the future.

An example of a monthly cash flow forecast can be seen below:

Figure 7 Cash Flow Forecast – Betty’s Cafe (\$,000)

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
Opening Balance	100	110	130	120	100	100	110	160	200	190	190	200
Inflows	50	60	50	50	70	90	120	130	100	80	60	50
Outflows	40	40	60	70	70	80	70	90	110	80	50	130
Net Cash Flow	-10	20	-10	-20	0	10	50	40	-10	0	10	-80
Closing Balance	110	130	120	100	100	110	160	200	190	190	200	120

A cash flow forecast is a critical financial management tool. It shows the business whether it will have enough cash at the end of each month to pay all its bills.

The cash flow forecast for Betty’s Cafe shows that the business will have an opening balance in July of \$100,000. This is money the business has in the bank from the previous trading year.

In July, the business is expecting total inflows to be \$50,000 and total outflows to be \$40,000 (Net Cash Flow of \$10,000) – which means that at the end of July the business will now have \$110,000 in its bank account. Because inflows for July are greater than the outflows, we would say that this month is “cash flow positive”.

The closing balance of \$110,000 now becomes the opening balance for August. The same process of adding inflows and outflows is followed, giving a closing balance for August of \$130,000. This process is replicated for the rest of the year all the way until June.

This business is not projected to have any cash flow problems because the closing balance at the end of each month is a positive number. It is worth noting, that for certain months the projected inflows are less than outflows (e.g. Sep, Oct, Mar, Jun) – these months have a “negative cash flow”. However, this is not an issue because the business has enough cash from previous months to cover the shortfall.

At the end of the financial year (June 30) the Finance Manager will then construct a similar financial statement, this time called a cash flow statement.

A cash flow statement is constructed based on what actually happened – as opposed to the forecast which is looking forward. Cash flow statements do the same basic job as a cash flow forecast – which is to track the flow of cash in and out of the business over a period of time.

Cash flow statements contain more detail than forecasts. They classify inflows and outflows in three specific ways, which are outlined below:

Operating Activities	Inflows or outflows from the day-to-day running of the business
Investing Activities	Inflows or outflows from the purchase or sale of business assets
Financing Activities	Inflows or outflows from borrowing, lending, issuing shares, or paying dividends

Once all transactions are categorised in this manner, the cash flow statement is constructed. The format looks different to that of a forecast, but the basic principles are the same. A sample cash flow statement can be seen below:

Figure 8 Cash Flow Statement

Cash Flow Statement – Betty’s Café (\$'000)		
Year ending – 30 June 2022		
Opening cash balance		\$ 100
Cash flow from operating activities		
Sales	\$ 910	\$ 910
Wages	\$ (190)	
Stock	\$ (130)	
Rent	\$ (220)	
Electricity	\$ (50)	
Phone	\$ (5)	
Advertising	\$ (85)	\$ (680)
Net cash flow from operating activities		\$ 230
Cash flow from investing activities		
Purchase of oven	\$ (75)	
Sale of delivery van	\$ 45	
Net cash flow from investing activities		\$ (30)
Cash flow from financing activities		
Bank loan	\$ (180)	
Net cash flow from financing activities		\$ (180)
Total increase/decrease in cash		\$ 20
Closing cash balance		\$ 120

When constructing and interpreting a cash flow statement, you need to be aware of the following accounting conventions

All outflows are represented by brackets, e.g. -\$500 is show as (\$500)

Transactions are recorded in the first column and sub-totals are calculated in the second column

It is very important to realise that cash flow statements do not show whether the business is making a profit. Profitability is covered in the next section (Income Statement).

Exercise 2.8 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. The three sections of a cash flow statement are operating activities, business activities and financing activities	
2. The central purpose of a cash flow statement is to manage the timing of payments	
3. A common accounting convention is to put brackets around negative numbers	
4. A cash flow statement shows whether a business is profitable	
5. A cash flow forecast is a prediction and can never be 100% accurate	
6. The two main transactions on a cash flow statement are assets and liabilities	
7. The three financial statement are cash flow, income and balance sheet	

■ Income statement

An income statement shows whether a business is making a profit.

You may be aware of the term **income** in relation to a person and the salary that they earn from their job. For example, a teacher might have an income of \$90,000 per year. Income for a business is how much the business “earns” – but instead of making a salary, a business makes a profit.

Income statements are sometimes referred to as “profit and loss statements”, or a “statement of financial performance”. These terms all mean the same thing.

Before looking at an income statement, you must be familiar with the following financial terms and formulas:

Financial Term / Formula	Definition
Revenue	All money coming into the business – also known as sales. Revenue is mostly from selling goods or services, but can also be from other sources like investments.
Profit	All revenue minus all expenses – also known as income .

Expenses	All money going out of the business – also known as costs . Can be further categorised as: <ul style="list-style-type: none"> ■ Selling expenses – any expenses directly linked to selling the product, e.g. salaries and commissions for sales staff, advertising, shipping. ■ Financial expenses – Insurance, and costs associated with borrowing or lending money. ■ Administrative expenses – all other “overhead” expenses that are not directly linked to making the product, e.g. rent, telephone, stationary, professional fees and senior manager salaries
COGS	The full term is Costs of Goods Sold (COGS) . A specific type of expense that relates directly to the production of the good or service.
COGS Formula	Opening Stock + Purchases – Closing Stock
Gross Profit Formula	Sales – COGS
Net Profit Formula	Gross Profit – Expenses

Five Key Sections of an Income Statement

Every income statement – no matter how complex or detailed it may look – is composed of five key sections. If you can memorise these sections in their correct order, it will greatly assist you in understanding and answering questions about income statements. The five key sections can be seen below:

1	Revenue	\$900,000
2	less COGS	\$230,000
3	Gross Profit	\$670,000
4	less Expenses	\$470,000
5	Net Profit	\$200,000

The income statement starts with revenue (1). We then minus COGS (2), which gives us the gross profit (3). We then minus expenses (4), which leaves us with net profit (5), also known as the income for the business.

Calculation of COGS

A sub-component of an income statement is the calculation of COGS. An example can be seen below:

1	Opening Stock	\$20,000
2	plus Purchases	\$240,000
3	less Closing Stock	\$30,000
4	GOGS	\$230,000

To calculate COGS we apply the COGS formula. We start with opening stock (1), then add purchases (2), minus closing stock (3), which leaves us with COGS.

Constructing a Detailed Income Statement

Constructing a fully detailed income statement is simply a matter of combining:

- The five key sections
- Calculation of COGS
- Categorisation of expenses – selling, financial and administrative

An example can be seen below:

Figure 9 Income Statement

Income Statement – Betty's Café (\$'000)			
Year ending – 30 June 2022			
Revenue			\$900
	Opening Stock	\$20	
	Purchases	\$240	
	Closing Stock	\$30	
less COGS			\$230
Gross Profit			\$670
Selling expenses	Website maintenance	\$5	
	Advertising	\$25	\$30
Financial expenses	Accountant's Fees	\$5	
	Depreciation	\$25	
	Interest	\$10	\$40
Administrative expenses	Rent	\$120	
	Utilities	\$10	
	Wages	\$250	
	Insurance	\$20	\$400
less Expenses			\$470
Net Profit			\$200

It is worth noting that every Finance Manager has their own specific preferences when constructing an income statement. You will never see two income statements that ever look exactly the same. However, they will always be constructed using the same methodology we have discussed in this section.

Exercise 2.9 Matching

Match the following statements to the correct term in the word bank below:

Statement	Term
1. The formula for this transaction is opening stock – plus purchases – less closing stock	
2. This transaction can be further categorised as selling, financial and administrative	
3. All revenue minus all expenses equal this	
4. Another term for an Income Statement	
5. The formula for this transaction is gross profit – less expenses	
6. Also known as sales – this transaction is a result of a business selling its products	

Word Bank: Profit and Loss Statement, Revenue, Profit, Expenses, COGS, Net Profit

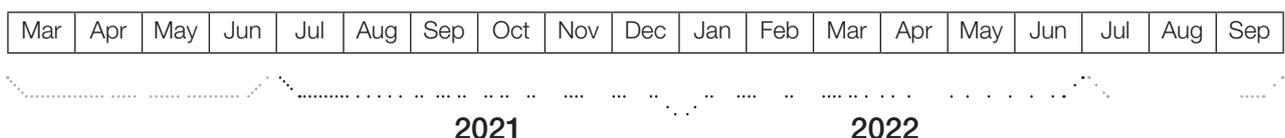
■ Balance sheet

A balance sheet shows what a business is worth – at a particular point in time.

Balance sheets are normally constructed at the end of the financial year. A financial year is different to a calendar year.

A financial year starts on 1st of July – goes for 12 months – and ends on 30th June. This means that a financial year spans across two different calendar years. This is illustrated in the timeline below.

The Current Financial Year



We can see this financial year runs from July 2021 to June 2022. Using accounting terminology we would describe this as “the current financial year”, “the 2021/22 financial year”, or “the financial year ending 30 June 2022”.

Components of a Balance Sheet and Key Formula

A balance sheet has three main components:

Assets Value of everything the business <u>owns</u>	Liabilities Value of everything the business <u>owes</u>
	Owners Equity Value of the owner's share of the business

These three components will each have a monetary value attached to them, which must "balance", i.e. add up to the same amount. This is represented by the balance sheet formula below:

$$\text{Assets} = \text{Liabilities} + \text{Owners Equity}$$

Key Financial Terms

To understand a fully detailed balance sheet, you must be familiar with the following financial terms:

Financial Term	Definition
Asset	Any item owned by the business – can be tangible or intangible.
Current Asset	Any asset that will be used by the business within 12 months, i.e., within the current financial year – e.g. cash, accounts receivable (also called debtors) and inventories (also called stock).
Non-Current Asset	Any asset that will be used by the business over a period of greater than 12 months, i.e., beyond the current financial year – e.g. buildings, land, equipment.
Liability	Money that is owed in the form of debt to banks and other businesses.
Current Liability	Debt that is expected to be repaid in the short term, i.e., within 12 months – e.g. Accounts payable (also called creditors), credit card, overdrafts.
Non-Current Liability	Debt that is expected to be repaid in the long term, i.e., greater than 12 months – e.g. mortgages, long term loans.
Owners Equity	The owner's "stake" in the business. If the entire business was sold and all debts repaid, this is what would be left over for the owner.
Capital	Money invested by the owner to start or expand the business
Net Profit	Total revenue – Total expenses
Drawings	Money taken out by the owner for their personal use

Accounts Receivables/Payables and Invoices

Before constructing a balance sheet, there is one final set of terms and concepts we need to cover – Accounts Receivables, Accounts Payables and Invoices.

When you buy any item you normally pay cash. For example, if you buy a packet of chewing gum, you walk into the store, hand over your money, and leave with the gum. However, when businesses buy and sell to each other, they conduct the financial transaction in a very different way.

If a furniture manufacturer (Bella's Tables) buys some timber from a lumber yard (Tom's Hardware), she does not immediately pay for the goods in cash. Instead, Tom's Hardware would deliver the timber to Bella's Tables and include an invoice for payment. This invoice is like a bill, with the normal terms of payment being 30 days. This means that Bella's Tables receives the lumber immediately so she can start making furniture, but she has 30 days before she actually has to pay Tom's Hardware for the goods. Tom's business is effectively giving her a short term loan.

Most businesses will receive goods on invoice and will also sell goods on invoice. This means that at any point in time, they will have accounts receivable – which are all invoices owed to the business. They will also have accounts payable – which are all invoices they owe to other businesses.

Accounting conventions assume that all accounts receivable invoices will eventually be paid – which is why they are listed as an asset in the balance sheet. Even though they are not yet “cash”, it is assumed that they soon will be, and thus are something of value that the business owns.

A Detailed Balance Sheet

A fully detailed balance sheet is comprised of the three key components (assets, liabilities, owners equity), along with details from the financial terms and concepts listed above.

Remember, the left hand side of a balance sheet must always equal the right hand side, i.e. $\text{Assets} = \text{Liabilities} + \text{Owners Equity}$.

A sample of a detailed balance sheet can be seen below:

Figure 10 Balance Sheet

Balance Sheet – Betty’s Café (\$’000)			
for year ending 30 June 2022			
Current Assets		Current Liabilities	
Cash	\$120	Payables (Accounts Payable or Creditors)	\$40
Receivables (Accounts Receivable or Debtors)	\$10	Credit Card	\$10
Inventories (Stock)	\$30		
Total	\$160	Total	\$50
Non-Current Assets		Non-current Liabilities	
Machinery	\$160	Long term loan	\$140
Motor Vehicle	\$55		
Furniture and Fittings	\$25		
Total	\$240	Total	\$140
		Total Liabilities	\$190
		Owners Equity	
		Capital	\$120
		+ Net Profit	\$200
		- Drawings	\$110
		Total Owners Equity	\$210
Total Assets	\$400	Total Liabilities + O.E.	\$400

In this sample balance sheet we can see that:

$$\text{Assets } (\$400,000) = \text{Liabilities } (\$190,000) + \text{Owners Equity } (\$210,000)$$

Exercise 2.10 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. The balance sheet formula is: Assets = Liabilities + Owners Equity	
2. Owners equity shows all the assets owned by the business	
3. Accounts receivable is money the business owes	
4. A liability is any money owed by the business	
5. The terms of an invoice are normally 365 days	
6. For a cafe, paper cups would be a current asset	
7. The financial year runs from January to December	

e) Human Resources

The Human Resources function involves hiring, training and managing the employees of a business.

If you have a part-time job after school, you would have interacted with the human resource function of your employer. You may have responded to a job advertisement, attended an interview or even signed an employment contract. At some point you may have also chosen to leave the job – hopefully you weren't fired!

The core concepts of human resources apply to part-time jobs, but some elements are more relevant to full-time workers who consider their job a career. These are employees who generally work at least 38 hours per week, usually from Monday to Friday.

The role of human resources has become more important in the modern economy because so many businesses are now involved in the tertiary, or service sector. In these types of businesses, people are central in delivering the product – and are critical to success. If a business is not able to hire the right people, train them, motivate them and treat them well – then it is unlikely to succeed.

■ Recruitment

Recruitment is the first step in the human resources cycle. It involves the hiring of staff.

Before an employee can be hired, the business needs to know exactly what it is looking for in the ideal employee. To determine this, a business needs to put together a job description and job specification. Details of these two documents can be seen below:

	Definition	Example – Car Mechanic
Job description	A written document that describes what the person in the job role does	<ul style="list-style-type: none"> ■ Efficiently and safely service and maintain a diverse range of vehicles following accepted trade practices ■ Undertake fault finding and diagnostics across a variety of vehicles. ■ Test drive repaired vehicles and park in workshop ■ Keep customers notified and up-to-date in relation to their service requirements. ■ Assist with other counter and workshop duties – such as customer service; answering phone calls; loading or unloading deliveries.
Job specification	A written document that outlines the specific qualifications, skills and experience needed to do the job.	<ul style="list-style-type: none"> ■ Qualified motor mechanic ■ 3+ years experience working with petrol and diesel engines ■ Current drivers licence ■ Excellent safety awareness and ability to follow safety procedures ■ Good computer skills ■ Good verbal communication skills ■ Excellent customer service skills

Once the job role has been defined, the business needs to decide how it is going to recruit the employee. There are two main options available:

Internal recruitment – The selection pool of candidates is limited to existing employees of the business. This generally means that someone will be promoted or transferred from another department of the business. The benefit of internal recruitment is that it motivates employees interested in career progression. It is also a less riskier option for managers as they already know the ability, skills and motivation level of the staff member.

External recruitment – the selection pool of candidates is expanded to anyone outside the business. This means the job must be advertised, usually on websites such as seek.com.au. The benefits of external recruitment is that a broader range of people with diverse skills and experience can brought into the business. The main disadvantage of external recruitment is that it is more costly and time consuming than internal recruitment.

The final step in the recruitment process is selection. This process may involve the following tasks:

■ Reviewing resumes and application forms
■ Administering IQ or personality tests
■ Interviewing shortlisted candidates
■ Conducting reference checks
■ Negotiating salaries and conditions

Selecting the right candidate for each job is a critical function of human resources. Making the wrong choice and hiring a person who is not a “good fit” can be detrimental to the business.

■ Training

Training involves teaching staff how to do their job properly.

Training has benefits for both the employee and the business. For the employee, it makes them feel valued and respected – which in turn leads to increased motivation and engagement at work. For businesses, it ensures that all staff know how to do their job correctly and safely – which in turn leads to satisfied customers, and thus increased sales and profits.

There are three distinct types or phases of training.

Induction	This happens when an employee first starts at a business and generally only happens once during their time of employment. Induction is like “introducing” the staff member to the business. The new staff member will not be expected to do their normal role, and instead will meet key people in the business, as well as learn about the product and key customers. Practical matters are also covered during induction – everything from payroll and company policies, to lunch times and the location of the toilets.
Training	Training involves teaching the staff member the practical steps involved in performing their job. Even though the new employee might come to the business with a lot of existing skills, every business operates slightly differently and there are always new processes to learn. Training should be an ongoing activity throughout the “life” of the employee. Changes in the external environment, particularly around technology, will prompt the need for further training.
Development	Development involves activities that will lead to long-term growth in the employee. It is a “step up” compared to training, and is usually conducted to prepare people for future leadership roles. Development focuses on enhancing management skills such as: communication; public speaking; strategic thinking; leadership; conflict resolution and people management.

All forms of training have a financial impact on the business – either directly through payment for items such as training courses, or indirectly through lost staff time. However, most successful businesses see training as an investment, rather than a cost.

■ Employment contracts

An employment contract is an agreement between an employee and employer.

Employment contracts are usually put in writing and outline the working conditions and expectations relating to a job.

When negotiating with each other, employees and employers must work within national workplace relations system that is outlined in the The Fair Work Act (2009).

The Fair Work Act (2009) outlines many entitlements that must be offered to all employees. These include the National Minimum Wage and the National Employment Standards (NES).

Case Study: Fair Work Ombudsman

The Fair Work Ombudsman was established in 2009. It is a Government Statutory Authority whose purpose is to help administer the Fair Work System in Australia. It's role is to educate and assist both employees and employers in understanding and implementing Australia's workplace relations system.

The Fair Work Ombudsman's website (www.fwc.gov.au) is a useful resource for Business Studies students. It contains detailed information and fact sheets on:

- The National Employment Standards
- The Minimum Wage
- Modern Awards
- Enterprise Agreements



Any employment contract cannot contain working conditions that are “less than” those outlined in the National Employment Standards. Similarly, an employee cannot agree to work for less than the national minimum wage, even if they want to.

■ Separation – Voluntary/Involuntary

Nobody keeps a job forever and eventually every employee leaves their workplace.

If an employee makes the decision to end the employment relationship, this is called **voluntary separation**.

If an employer makes the decision to end the employment relationship, this is called **involuntary separation**.

The table below summarises different employment separation scenarios:

Voluntary Separation – decision made by employee	
Retirement	This is when someone has reached the end of their career and no longer can, or wants to work. People wanting to receive the government Age Pension cannot retire until 67.
Resignation	This is when someone has a new job, or wants to take a break from working. If an employee resigns, they need to give their employer notice of their intention – which is usually either 2 or 4 weeks.
Voluntary Redundancy	Some employees are happy to take a redundancy offer from their employers because they wish to benefit from the redundancy pay. These employees are usually unhappy in their current role and see the redundancy as an opportunity to make a change.
Involuntary Separation – decision made by employer	
Redundancy	This is when a business needs to shed some of its workforce, either because the business is losing revenue or because certain jobs are being replaced by technology. If a business makes an employee redundant, they must offer “redundancy pay”, which is an extra payout of between 4-12 weeks wages – depending on how long the employee has been with the business.
Summary dismissal	This is when an employee is “fired on the spot” for serious misconduct such as theft, fraud, assault, intoxication at work, or the refusal to carry out reasonable instructions.
Dismissal after warnings	This is when an employee is “fired” due to poor performance and not doing their job properly. Although it is not a legal requirement, most employers will give three written warnings before firing an employee. This gives the employee ample opportunity to improve their performance.

f) Ethical Business Behaviour

The primary goal of any business is to make a profit. However, increasingly businesses are also expected to act ethically and be “good corporate citizens”. Just as an individual can be a good person by behaving in an ethical and socially responsible manner, so too can a business.

A business can act ethically in the following ways:

Staff relations	An ethical business will treat its staff fairly and support them in times of hardship. They will see their employees as an “asset” rather than a “cost”.
Business practices	When dealings with other countries, an ethical business will ensure that foreign workers are paid a fair “living wage” based on local conditions. They will also ensure that they don’t directly or indirectly support practices such as “sweatshops” or child labour.
Environment	An ethical business will ensure that it minimises its carbon footprint and production of waste or pollution.
Social Issues	Ethical businesses often involve themselves in social justice issues – such as fighting for the rights of refugees; or working to assist Australia’s Indigenous community.

The benefits of ethical business behaviour include:

Differentiation from competitors	Whilst many businesses state they want to act ethically, few have the leadership and commitment needed to fully incorporate the strategy over the long term.
Motivated staff	Given the opportunity, most people would prefer to work for an ethical business. Staff working at such firms tend to be highly motivated which means they ultimately produce better goods and services for the business.
Satisfied customers	Most people prefer to purchase goods and services from ethical businesses. Such people will also be prepared to pay the higher prices needed to produce ethical goods, and will be more likely to remain loyal to the business.

If a business remains consistent in its commitment to ethics, they will eventually benefit from a “virtuous cycle” as illustrated in the diagram below:

Figure 11 The Virtuous Cycle of Ethical Business Behaviour



For a company to pursue ethical business behaviour they must take a long term view. It is often costly to act ethically, which will affect short term profits. Few businesses show the commitment to overcome this initial hurdle and thus do not get the long term benefits of the “virtuous cycle”.

Exercise 2.11 Matching

Match the following statements to the correct term in the word bank below:

Statement	Term
1. This activity involves showing employees how to do their job correctly	
2. This activity involves a business being a “good corporate citizen”	
3. This activity has two types – voluntary and involuntary	
4. This is the first step in the human resources cycle	
5. This may result from serious misconduct at work, such as theft or assault	
6. This activity is often reserved for people in the business who have leadership abilities	
7. Amongst other things, this business function is responsible for hiring new employees	

Word Bank: Human Resources, Recruitment, Training, Development, Separation, Summary dismissal, Ethical Business Behaviour

4. Management and change

Over the past 50 years the business world has changed immeasurably. This change continues on to the present, and is accelerating year by year. There are two main drivers for all this change:

Technology	Technology consists of any tool or machine that allows humans to do something in a new or more efficient way. We often think of computers when we discuss technology, but in reality it is a much broader concept that includes areas as diverse as: transport, energy, agriculture, robotics, medicine, science, artificial intelligence and space exploration.
Globalisation	Globalisation is a trend that has seen the production of goods and services cross national borders. Globalisation has been made possible due to changes in technology – specifically transport, IT and telecommunications. Because of globalisation, most Australian businesses must now compete internationally.

In the past, if a business had an excellent product that met its customers' expectations, then it had a good chance to succeed. But in the modern business world, this is no longer enough. Today, a company's ability to succeed is also highly correlated with its ability to adapt to change.

a) Responding to internal and external influences

In topic 1, *The Nature of Business*, we explored a variety of internal and external influences that impact on a business. These influences are listed below:

External Influences		Internal Influences
Economic	Political	Products
Financial	Institutional	Location
Geographic	Technological	Resources
Social	Competitive Situation	Management
Legal	Markets	Business Culture

A successful business must be able to adapt to each of these influences as they inevitably change over time. Sometimes these changes will be fast and dramatic, and at other times they will be slow and incremental.

As a business identifies the need for change, it must adapt its KBFs accordingly. Sometimes only one KBF might need to be modified, e.g. Marketing. However, due to the interdependence of each KBF, it is most likely that all four will require some degree of modification.

b) Managing change effectively

Change Management is the process of modifying a businesses KBFs in response to internal or external influences. A modern manager must be highly proficient in change management and should conduct the process in a fair and methodical manner.

Change is inevitable. Sometimes its effects are positive and sometimes they are negative. A manager who is skilled in change management will maximise the benefits brought about by change, and minimise the impact of any likely downsides.

The following processes need to be followed by a manager in order to ensure they manage change effectively.

■ Identifying the need for change

Before conducting a change management process, the business must first identify the need for change. Business change is both disruptive and expensive, so any change management program needs to be fully justified with evidence.

This can be obtained in the following ways:

- Scanning the external business environment and looking for trends
- Analysing internal business data, such as sales figures
- Obtaining feedback from staff
- Obtaining feedback from customers

Case Study: Peters of Kensington



Established in 1977, Peters of Kensington is a family-owned retail store located in Sydney's affluent Eastern Suburbs. The business focuses on selling high-end homeware brands at affordable prices. They stock cookware, tableware, electrical appliances and gifts – from prestigious brands such as Royal Doulton, Wedgwood, KitchenAid, Nespresso, Scanpan, Le Creuset, Lladro and Ralph Lauren.

The business has been remarkably successful, competing against much larger retailers such as Myer and David Jones. Their flagship store in Kensington has 3 levels of shopping, a cafe and a bridal registry. They also have three other stores in Birkenhead Point, Barangaroo and Alexandria.

Like many retailers, Peters of Kensington noticed a major shift toward online shopping in the early 2000s. They were faced with a major decision – resist the change, or change their business model. The owners chose the latter, and invested heavily in moving their business online to petersofkensington.com.au – while still preserving their “bricks and mortar” heritage. Because of this open minded approach to change, the company remains successful to the present day.

■ Business information systems

Business Information Systems (BIS) are information technology tools that further assist managers in identifying the need for change. BIS consist of digital information that is contained in databases, websites, online surveys, financial systems and spreadsheets.

To make the data contained within BIS's "human readable", managers run reports that analyse and interpret the data. The data is then usually converted into visual formats, such as pie charts, graphs or tables – which are used by managers to assist in making business decisions involving change.

For example, a BIS may be used by a car company to analyse its sales data. This data might be converted into a pie chart, which is then used by managers to decide which of its models are most popular, and thus appropriate for export to another country – and which of its models are most unpopular, and thus need to be discontinued.

■ Setting achievable goals

Once management has identified the need for change, they must set goals so they can achieve the desired change.

In setting change management goals, managers must be mindful to ensure the goals they set are realistic and achievable. For this reason, they will often use SMART goals – which is an acronym that stands for:

S – Specific

M – Measurable

A – Achievable

R – Realistic

T – Timely

For example, suppose that a small cafe has identified the trend in society towards gluten free diets, and wants to change its business to accommodate for this trend. It might set the following SMART goal: "Introduce 3 new gluten free dishes onto the cafe menu within the next 4 weeks".

■ Resistance to change

Few people are receptive to change, and in fact, most are quite resistant. Part of human nature is "liking things the way they are" – and given the choice, most of us prefer our familiar patterns and ways of doing things.

This human trait to resist change is also seen in the world of business. The following table highlights some of the key reasons why management and staff may resist change.

Cost	There is often a large up-front cost involved with any major change management program. Managers are resistant to these costs because they will affect short term profits. Specific costs can include: new equipment; changes to facilities; redundancy payments to workers no longer needed by the business; and retraining costs for staff who need to develop new skills.
Communication	Managers must let staff know the reasons why the change is needed, and if necessary, its level of urgency. Communication on the need for change must be clear, timely and accurate.
Consultation	Whenever possible, managers must consult with staff on the upcoming change. This increases the chances for staff “buyin” to the process.
Trust	Staff will be less resistant to change if they trust the judgment of management, and believe that they will be treated fairly and equitably in the change process.
Fear	Most people fear the unknown and some will even “catastrophise” when faced with uncertainty. Wherever possible, managers must mitigate these fears with clear communication – otherwise gossip and rumours will take over.
Rewards	Staff must be aware of the rewards and benefits associated with the change. People who are resistant to change often focus solely on the negatives, and fail to see the positives.
Job loss	Most employees want to leave a job on their own terms, and few want to lose their jobs through redundancy.
Status	Staff may fear that their job will “lose status”, either due to changes in pay, conditions, or responsibility.
Uncertainty	Any major change program will lead to a certain degree of uncertainty. No matter how well management communicates the process and tries to plan for every eventuality – there will always be some elements that cannot be predicted.

■ Management consultants

Management consultants are external experts that hired by the business to assist it in implementing a change management program. They are normally only used when the change required is significant and will have a major impact on the business.

Management consultants usually have specific skills, expertise or knowledge that is not possessed by the businesses’ managers. This could include:

- Strategic vision on the industry within which the business operates
- Experience from other businesses that have gone through similar changes
- Access to specific technology or processes that will assist with the change
- Expertise in developing communications strategies
- Expertise in developing HR strategies to assist staff through the change process
- Expertise in redundancy or retraining

Exercise 2.12 True or False

Indicate whether the following statements are true or false.

Question	True/False
1. Databases and spreadsheets are two examples of business information systems	
2. Change can be both disruptive and expensive	
3. Management consultants are usually employed to assist with minor or small change management programs	
4. Businesses need to change only due to external influences	
5. Resistance to change is part of human nature	
6. Changes in the external environment always have a negative effect on businesses	
7. The two main drivers behind business change in recent decades are technology and globalisation	

Exercise 2.13 Multiple Choice

1. In relation to effective management, what does the acronym POLC stand for?
 - A. Planning, Operations, Leading, Controlling
 - B. Preparation, Organising, Leading, Controlling
 - C. Planning, Organising, Leading, Controlling
 - D. Planning, Organising, Leadership, Commanding

2. Gemma is a CEO at a major petroleum company. To succeed in her job she must be able to balance the views of customers, shareholders and staff when making business decisions. Which skill of management is most relevant to this activity?
 - A. Interpersonal
 - B. Communication
 - C. Reconciling the conflicting interests of stakeholders
 - D. Decision-making

3. Which of the following is the primary goal for most businesses?
 - A. Profits
 - B. Market share
 - C. Growth
 - D. Share price

4. Sam has successfully run his own plumbing business for the past 25 years. He employs a total of 6 staff. He does not seek input or feedback from his staff in how to run the business as he considers that his job as a manager. Which leadership style is Sam using?
 - A. Participative
 - B. Democratic
 - C. Contingent
 - D. Autocratic

5. Managers who adopt the behavioural approach believe that management is a process which involves:
 - A. Leading, Motivating, Communicating
 - B. Planning, Organising, Controlling
 - C. Planning, Learning, Communicating
 - D. Presenting, Organising, Controlling

6. Betty has had a long career as a CEO of several major corporations. She considers one of her best qualities to be adaptability – being able to change her management approach based on the circumstance of the business she is running. Which management approach is Betty adopting?
 - A. Autocratic
 - B. Contingency
 - C. Behavioural
 - D. Participative

7. There is a saying that “a chain is only as strong as its weakest link.” Which business studies concept relates most closely to this saying?
 - A. Interdependence
 - B. Strategy
 - C. Vision
 - D. Goal setting

8. What are the three elements involved in the production process?
- A. Inflows, Transformation Processes, Outflows
 - B. Inflows, Innovation, Outflows
 - C. Inputs, Mechanisation, Outputs
 - D. Inputs, Transformation Processes, Outputs
9. Rosanna owns a small Italian restaurant and is experiencing a decline in sales. She has received feedback from customers that her food is good, but that the furnishings and decor in the restaurant is outdated. In an effort to improve her business, Rosanna has decided to do a major renovation. Which component of the marketing mix is Rosanna modifying?
- A. Price
 - B. Product
 - C. Place
 - D. Promotion
10. Which of the following financial statements determines if a business is making a profit?
- A. Income statement
 - B. Balance sheet
 - C. Cash flow statement
 - D. Cash flow forecast
11. Which of the following can be both a voluntary or involuntary form of separation?
- A. Retirement
 - B. Resignation
 - C. Redundancy
 - D. Dismissal
12. Tom runs a small legal firm that specialises in immigration law. He often does “pro bono” or free work in his spare time to assist refugees with their visa applications. Which business studies term best describes Tom’s actions?
- A. Voluntary ethics
 - B. Social justice
 - C. Charity work
 - D. Ethical business behaviour

13. Paul owns a small motor mechanic workshop and has recently employed Jane, a young female apprentice. She has complained that the older men in workshop are rude – making sexist and offensive jokes at her expense. Paul wants to change the business to be more accomodating of Jane. Which internal influence does Paul have to modify to fix the problem?
- A. Social
 - B. Political
 - C. Institutional
 - D. Business Culture
14. Which business studies term refers to the process of modifying a businesses KBFs in response to internal or external influences?
- A. Change management
 - B. Process management
 - C. Performance management
 - D. Profit management
15. Which of the following is not a skill possessed by management consultants
- A. Strategic vision on the industry within which the business operates
 - B. In depth and detailed knowledge of the business they are assisting
 - C. Expertise in developing communications strategies
 - D. Access to specific technology or processes that will assist the business

Exercise 2.14 – 10 marks

Karen has just taken over as CEO of Funtimes Furniture – a large Australian business that sells furniture in 30 stores across the nation. The business has been facing declining sales and shrinking profits in recent years. Karen has been brought in as CEO to turn the company around. The senior management team at Funtimes Furniture is dysfunctional and nobody is quite sure about the vision or strategic direction of the business. Staff are unsatisfied and there have been many resignations in the last 12 months.

- a. Outline one skill of management that will assist Karen in turning the company around? (2 marks)

b. Identify a business goal that Karen should focus on in her first 12 months as CEO? (2 marks)

c. Describe how Karen could use staff involvement to help achieve her goals? (2 marks)

d. Discuss one management approach that Karen could utilise to turn the company around? (4 marks)

Exercise 2.15 – 10 marks

Tina and Amy are looking to buy an established Cafe in Annandale, a trendy inner-city suburb of Sydney. The cafe caters to young hipsters who enjoy great coffee in a cool and funky environment. The business will cost them \$750,000 to buy. They are committing their life savings to the purchase and will also take out a large loan. They are currently analysing the business to see if purchasing the business is a good idea.

a. Outline whether the Cafe is selling a good or service?

(2 marks)

b. Identify one aspect of the marketing mix and how it might apply to the success of this business.

(2 marks)

c. How could Tina and Amy modify the business to ensure it engages in ethical business behaviour

(2 marks)

- d. Explain how Tina and Amy can use one financial statement to determine the financial viability of the business. (4 marks)

Answers to Exercises

Exercise 2.1

1.F, 2.F, 3.T, 4.T, 5.F, 6.F, 7.T, 8.F, 9.T, 10.T

Exercise 2.2

1. Environmental, 2. Market Share, 3. Share Price, 4. Social, 5. Profit, 6. Growth

Exercise 2.3

1.F, 2.T, 3.T, 4.F, 5.T, 6.F

Exercise 2.4

1.T, 2.F, 3.F, 4.T, 5.T, 6.F, 7.T

Exercise 2.5

1. Feedback, 2. Teams, 3. Recognition, 4. Contingency, 5. Participative/democratic, 6. Empathy

Exercise 2.6

1. Inputs, 2. Production Process, 3. Control, 4. Operations, 5. Good, 6. Interdependence

Exercise 2.7

1.F, 2.T, 3.F, 4.T, 5.T, 6.F, 7.F

Exercise 2.8

1.F, 2.T, 3.T, 4.F, 5.T, 6.F, 7.T

Exercise 2.9

1. COGS, 2. Expenses, 3. Profit, 4. Profit and Loss Statement, 5. Net Profit, 6. Revenue

Exercise 2.10

1.T, 2.F, 3.F, 4.T, 5.F, 6.T, 7.F

Exercise 2.11

1. Training, 2. Ethical Business Behaviour, 3. Separation, 4. Recruitment, 5. Summary dismissal, 6. Development, 7. Human Resources

Exercise 2.12

1.T, 2.T, 3.F, 4.F, 5.T, 6.F, 7.T

Exercise 2.13

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

Exercise 2.14

- a. Answers could include: Interpersonal, communication, strategic thinking, vision, problem-solving, decision making, flexibility, adaptability to change, reconciling the conflicting interests of stakeholders

Sample Answer: Vision is the ability of a manager to formulate and implement a long term plan for the business. Because Funtimes Furniture is lacking direction, developing a vision is the first step in getting the business back on track.

- b. Answers could include: profits, market share, growth, share price, social, environmental

Sample Answer: Profit is the primary goal for most businesses. If a business is not making a profit it has no long term future. Because Funtimes Furniture has declining profits, Karen should make this goal her top priority.

- c. Answers could include: Innovation, motivation, mentoring, training

Sample Answer: A manager like Karen can lead a business and set goals, but if she does not have staff involvement then it unlikely she will succeed. Karen could look at motivating staff by bringing in bonuses for top performing sales staff.

- d. Answers could include: Classical approach, behavioural approach, contingency approach

Sample Answer: The classical approach to management is focussed on the idea that there is “one best way” to run any business. Because Funtimes Furniture is facing such serious problems it might be best to implement this approach. An advantage of using the classical approach is that it provides clear guidelines on how the business will be run and what will be expected of staff and managers. A disadvantage of this approach is that existing staff may have good ideas on how to improve the business, but it is unlikely that their opinions will be heard with a classical hierarchical management structure.

Exercise 2.15

- a. Answers could include: goods and/or services

Sample Answer: The cafe is selling both a good and a service. The good is the tangible aspects of the product offering such as the coffee and food. The service is the intangible aspects such as the wait staff, customer experience and cafe ambiance.

- b. Answers could include: product, price, place, promotion.

Sample Answer: Promotion includes any activity that makes customers aware of the cafe. The business may be successful because it has a strong following on Instagram, or good reviews on “foodie” social media platforms.

- c. Answers could include: ethical business behaviour

Sample Answer: Ethical business behaviour involves businesses trying to be “good corporate citizens”. They could modify the business to behave ethically by giving discounts to customers who bring “keep cups” to the cafe, which would reduce the overall carbon footprint of the business.

- d. Answers could include: Cash Flow Statement, Income Statement, Balance Sheet.

Sample Answer: Tina and Amy could use an income statement to determine the profitability of the business. An income statement contains five main sections: Revenue; COGS; Gross Profit; Expenses; and Net Profit. Expenses are further divided into selling, financial and administrative. Not only will the income statement show overall profitability, but it may also highlight areas where the business could be improved. For example, there may be an opportunity to reduce specific administrative expenses which will improve the net profit of the business.

Chapter 3

Business Planning

1. Small to medium enterprises

a) Definition

Small to medium enterprises (SMEs) are typically hard to define and there is often no universal definition. Rather, common characteristics or features are used to classify business as a SME. These measures are both quantitative and qualitative in nature. Some common characteristics or features used include:

- number of employees and owners
- legal structure
- market share
- sources of finance

The Australian Bureau of Statistics (ABS) classify business size by the number of employees, that is:

- Micro business = sole traders and partnerships without employees
- Small business = employing less than 20 people
- Medium business = employing more than 20 but less than 200 people
- Large business = employing 200 or more people

Other common characteristics of small to medium enterprises are:

- Dependence on few employees
- Are typically sole traders and partnerships (legal structure)
- Small percentage of the total market (market share) and
- Focus on a small number of products and services
- Rely on personal assets of owners to finance the business
- Flexible and can make changes quickly

b) Role

Collectively SMEs play a significant role within the Australian economy. In Australia, SMEs:

- Employ approximately 70% of all private sector employees
- Produce approximately 50% of goods and services

- Generate increasing number of exports (including primary and agricultural exports and services like tourism and education) and
- Contribute significantly to government taxes (personal PAYG, GST and company).

c) Economic Contribution

Goods, services, innovation and job creation are the foundations of a healthy economy. Australia relies on the entrepreneurial strength and character of SME's to deliver these precious resources. SMEs contribute to the Australian economy in many ways, including:

- Contributing to 50% of Australia's Gross Domestic Product (the total monetary value of all goods and services produced in Australia over a one-year period) leading to economic growth.
- Contributing to approximately 70% of all private sector employees (employment).
- Contributing to the balance of payments (summarises the economic transactions between Australia and the rest of the world) by accounting for 90% of all exporting firms in Australia. SME's are a much smaller player in terms of their contribution to the value of exports. They only account for about 5% of all Australian exports.
- Contributing to invention and innovation (about 33% of all research and development in Australia). Many of the most innovative ideas and inventions in Australian business come from SME's. The contribution of SME's to invention and innovation has increased considerably in recent years, with new technologies lowering the barriers that traditionally prevented their entry into larger markets.

d) Success and/or failure

Many entrepreneurs are successful in assuming the risks of starting up a business. These business owners can turn their skills and passion into a profitable venture. Often, similar factors contribute to successful SMEs including:

- Flexibility – proactive and reactive within the internal and external business environments
- Strong reputation – quality products and service
- Focus on their identified target market – create repeat customer base
- Enact entrepreneurial abilities – driven and thrive on business challenges
- Access information – need to remain up to date

However, SMEs also have high failure rates. In Australia, 7 in 10 SMEs fail within the first five years of operation. An SME can be classified as a failure when it is incorporated and declared bankrupt or incorporated and forced to liquidate or choose to close their doors. SMEs fail due to several reasons including:

- Financial pressures
- Lack of planning, information, experience or market knowledge

- Mismanagement
- Poor location
- Competition
- Economic downturn
- New taxes

Exercise 3.1 True or False

Indicate whether the following statements are true or false.

	True/False
1. SMEs play a significant role in the Australian economy.	
2. By number of employees, a small business is classified as having 0-200 employees.	
3. A small to medium enterprise is universally defined.	
4. SME contribute approximately 50% of Australia's Gross Domestic Product annually.	
5. Someone who assumes the risks of starting up their own business venture can be called an entrepreneur.	

2. Influences in establishing a small to medium enterprise

When establishing a small to medium enterprise, owners must take into consideration a number of influences that will impact on their business's success.

a) Personal Qualities

Not all business owners will have the same personal qualities. However, it is a combination of common personality traits and attributes that will contribute to a business's success.

■ Qualifications

Whilst no formal qualifications or skills (education, training and previous experience) are required to run a business, the owners with business management training and/or qualifications or industry specific training and/or qualifications from university, TAFE or private colleges best equip the owners in running a successful business.

■ Skills

Various skills are needed to help start and manage a SME. Many skills are considered vital to running the day to day business operations and long-term management of the business and these skills must be developed or improved so that the business can succeed. Some of these skills include:

- **Financial management:** Being able to effectively manage your finances is critical. A business owner must forecast cash flow and sales and monitor profit and loss.
- **Sales and customer service:** To effectively be able to promote the business' products or services, providing good customer service will help generate sales.
- **Communication:** Having effective written and verbal communication skills will assist the owners to build good working relationships with suppliers, potential investors, customers and employees.
- **Leadership:** It is important to be able to motivate your staff in order to get the best out of them and improve productivity.
- **Problem-solving:** Every business will encounter problems and for this reason, you need to be able to make good decisions, sometimes under pressure.
- **Project management and planning:** Knowing how to effectively manage your resources, including time, money and staff will help you to achieve the business goals.
- **Delegation and time management:** Managing your time effectively may mean delegating responsibility or tasks to employees of the business. This requires trust in your employees, their skills and allows you to concentrate on other tasks that generate revenue.
- **Networking:** Building relationships and rapport with support services is vital to the success of the business.

■ Motivation

Motivation refers to having a reason or purpose for doing something and having a desire to do it. Motivation is the reason that compels someone to continue striving and working. It provides hope and clarity when circumstances become hard and discouraging. Motivation is fundamental in someone's decision to embark on establishing an SME. Typical factors which motivate entrepreneurs to set up SMEs are the desire to be your own boss, wanting greater financial stability, freedom and flexibility in how they structure their careers and greater creative control.

Entrepreneurs need to understand, tap into, and sustain their own motivation for starting a business, but they also need to be able to motivate others (like investors and employees) to buy into their idea.

■ Entrepreneurship

An entrepreneur is someone who, with the aim of making a profit, starts a business venture assuming all risks. Entrepreneurship is the process the entrepreneur undertakes. Often the business owner must weigh the benefits and the risks of such business opportunity as it is the assumed risk which can result in business success.

■ Cultural Background

A person's cultural background can influence how a business is established and operates. The ideas, traditions and expectations can come from one's cultural background and shape an individual's work ethic and how the business is run. Sometimes culture equips a person to run an SME. Migrants own and run one third of SME's in Australia often because their overseas qualifications may not be recognised in Australia. 83% of those owners, have never started/owned a business prior to migrating to Australia and 51% of them have a college degree or higher (compared to non-migrant business owners (38%).

Case Study Frank Lowy

Another successful immigrant is mega-mall-magnate Frank Lowy. He spent part of his childhood in a detention camp in Cyprus and a detainee camp in Palestine. He joined his family in Australia in 1952 and along with John Saunders (another Hungarian immigrant) developed his first shopping centre at Blacktown in Sydney in 1959. The Westfield Group operates one of the largest shopping centre portfolios in the world. The Company was recently sold for \$25 billion.



■ Gender

Historically, men were predominantly the owners of small to medium enterprises in Australia. However, this is rapidly changing today. There is a growing cohort of women owning their own SME and women now account for 33% of SME owners with as many as three times as many women start-ups compared to men. This is largely because of the flexibility of running your own business and the increased prominence of entrepreneurial women in the media. Studies also show that women generally are better at running an SME and have a lower failure rate because they are more multiskilled and organised, are better at listening to advice (more honest about the business) are better communicators and negotiators (connecting and engaging with customers and staff) and appreciate the value of creativity.

b) Sources of information

Gathering as much information from a variety of sources before starting up a SME is vital as no business owner can know all the necessary information needed. Information can be accessed from a range of sources and provides business owners with many avenues of help and advice. Seeking out such information assist business owners by providing consumer insight about similar businesses currently in operation, handy 'know-how' tips of the trade and industry related research and statistics. Some common sources of information include the Australian Bureau of Statistics, local state and federal government departments, accountants and solicitors, universities or TAFE and other business associates.

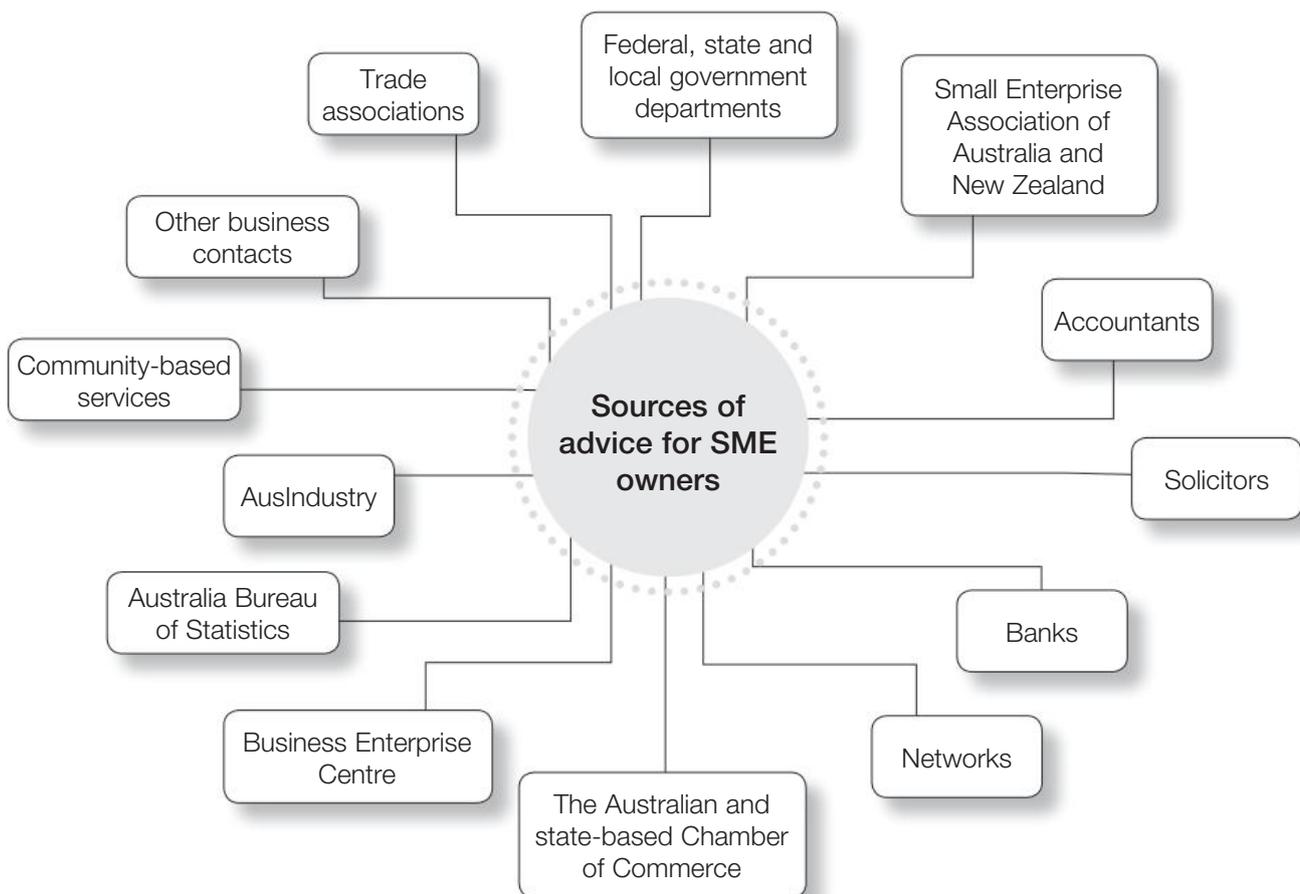
There are many government resources to help you start a business, from checklists and templates to formal training programs. The Australian Government's bus.gov website is a

comprehensive resource for anyone thinking of starting a business. This website covers all aspects of starting a business from start to end, covering topics such as:

- Prepare yourself for business
- Starting a business
- Business planning
- Advice on how to handle your tax, finances and superannuation.

The National Small Business Support Line is available to SME business owners to help better manage their business. AusIndustry, a division of the Department of Industry, Innovation and Science, is another portal of information for businesses with getting information to help owners set up and run their business, develop and commercialise ideas and products and reach new markets. The Department of Foreign Affairs and Trade provide specific advice to businesses on issues like exporting overseas and researching and developing new products and their release into new markets.

Figure 12: Sources of advice for SME owners



c) The business idea

A business idea is a concept that can be used to make money. Usually it centers on a product or service. An idea is the first milestone in the process of founding a SME. Every successful SME started as someone's idea.

A promising business idea must have the following characteristics:

- Relevant (must fulfill customers' needs or solve their problems)
- Innovative
- Unique
- Clear focus
- Profitable in the long run

The acceptability and profitability of a business idea usually hinges on how innovative the idea is.

d) Establishment options

There are 3 main ways of going into business:

- Starting a new business from scratch
- Purchasing an existing business or
- Purchasing a franchise.

Each option has its own advantages and disadvantages and must be carefully considered before an individual chooses which establishment option.

■ Starting a new business

Starting a new business completely from scratch can be timely and costly yet flexible for business owners. About 68% of MSE's start this way.

Advantages and disadvantages of starting a new business

Advantages	Disadvantages
<ul style="list-style-type: none"> ■ Usually the cheapest option (you aren't paying for goodwill or a franchise fee) ■ Gives business owner freedom to set up the business exactly how they want. Greater flexibility in decisions (aren't the restrictions of a franchise or what the previous owner decided) ■ Avoids the problem of poor reputation among customers, suppliers and staff 	<ul style="list-style-type: none"> ■ Riskiest option (may not break-even or make a profit for some time) ■ Owners usually experience poor cash flow in the establishment stage ■ Funds are often limited and obtaining finance is more difficult until a trading track record is established ■ Time is needed to build a customer base (need to spend a lot on promotional expenses to make customers aware of the business) ■ Suppliers may be reluctant to initially supply you credit.

■ Purchasing an existing business

Purchasing an existing business is a favourable option for many individuals looking at becoming a business owner. When buying an existing business, the selling price is usually a 'total package' and include the stock, premise/outlet (continuing lease or ownership), equipment, existing customer base and goodwill. The goodwill of any business is the monetary value given to the business' reputation. This can be attractive for new owners as a well-known reputation means instant business. Although, goodwill can be a costly addition to the selling price and must be carefully considered before purchase.

Advantages and disadvantages of purchasing an existing business

Advantages	Disadvantages
<ul style="list-style-type: none"> ■ Business is already running with an established customer base and immediate cash flow ■ Often considered less risky (better chance of survival, successful businesses may continue to be successful) ■ Employees and suppliers in place ■ Established trade credit with suppliers ■ Easier access to financing (perceived to have a lower risk from banks because of previous trading history) ■ Leverage the experience of the previous owner 	<ul style="list-style-type: none"> ■ More expensive because you are paying for goodwill ■ Equipment and facilities might be inefficient or obsolete ■ The business may be losing money (maybe for sale because it is no longer profitable) ■ The business maybe overpriced (many people purchase businesses at prices far in excess of their true value) ■ There can be some resentment from current staff ■ Location could be a reason for previous owners selling. This can be costly to change. ■ Business may be built on the qualities of the owner ■ Existing image and reputation of business can be hard to change (paying for ill will)

■ Buying a franchise

Another option for establishing a business is buying a franchise. A franchise is contracted agreement between the franchisor and the franchisee to use the business idea of an existing business under the exact same format; name, products, business operations and marketing. A franchisor is the business owner behind the original business idea and grants permission to the franchisee. Whereas, the franchisee is the business owner who buys the rights and uses the business idea from the franchisor. An initial franchise fee is paid as well as ongoing royalties (typically a percentage of the gross sales revenue). It is also the expense of the franchisee to fit out franchised business as specified in the franchise agreement. Ongoing business support is given by the franchisor.

Figure 13: Australia's top franchises and their establishment costs

Franchise	Description	Estimated franchise cost
 poolwerx for healthy pool people	Pool cleaning franchise (retail and mobile)	\$50,000 - \$100,000
 BatteryWorld	Battery product retailer for mobile, appliance and automotive batteries	\$200,000 - \$250,000
 Gelatissimo	Italian-style, hand-crafted gelato franchise	\$250,000 and up
 Bakers Delight	Baked goods	\$350,000 - \$500,000
 Roll'd	Vietnamese food franchise	\$350,000 - \$500,000
 MAD MEX FRESH MEXICAN	Fast casual Mexican restaurant	\$375,000 - \$450,000
 THE COFFEE CLUB.	Café providing “good food, great service and excellent coffee”	\$450,000 - \$700,000

A recent Franchising Australia survey reported that there are currently 1,160 Australian franchise systems and an estimated 79,000 franchise units in Australia. These include businesses like Boost Juice, Bakers Delight, Gelatissimo, Hire a Hubby and Jim's Mowing. The franchise industry contributes about \$144 billion to the Australian economy annually, generating almost half a million jobs.

Advantages and Disadvantages of buying a franchise

Advantages	Disadvantages
<ul style="list-style-type: none"> ■ Business name and products are likely to be well known to consumers and market for the products or services is already established ■ Ongoing business support and training is given by the franchisor ■ Reduced risk of business failure (well known proven formula) ■ Easier to obtain finance with known name and products ■ Stock relationships often already established with franchisor ■ Bulk buying of stock can provide attractive discounts (cooperative buying power) 	<ul style="list-style-type: none"> ■ Buying a franchise can be expensive (establishment fee and ongoing royalty) ■ Franchise fit-outs can also be expensive ■ Operating rules are set down by the franchisor (less independence, restrictions on decision making) ■ Franchisor must also approve the location for new outlet and can be expensive depending on visibility

Exercise 3.2 Advantage or Disadvantage

Determine whether the following statements are an advantage and/or disadvantage.

When establishing a new business	Advantage or Disadvantage?
The business owner can make all business decisions	
No customer base established	
Hard to obtain finance without any previous sales	

When purchasing an existing business	Advantage or Disadvantage?
Established customer base	
Easier to obtain finance to assist with growing the business	
Equipment and location already chosen and/or established	

When buying a franchise	Advantage or Disadvantage?
Business name, idea and products already known	
Franchise fee	
Buying a franchise is usually more expensive than establishing a new business	

e) Market

Key market considerations that influence the establishment of a SME are where the market is (its location), what is sold at market (goods and/or services) and for what price the product will sell.

■ Location

Location as a market consideration is choosing where the business will be located and how it will attract its customers (and future sales). This is an expensive decision for any business. Choosing whether to be in a shopping centre, strip mall, online only, at home or a combination of these locations; a business owner must justify the expense which is attached to any location. Businesses today are moving away from choosing traditional business locations like shopping centres which attract maximum exposure yet charge huge rents. Instead, choosing to integrate

technology as a business platform like social media to advertise and generate sales with reduced overheads. Some important locational factors include:

- Proximity to customers and suppliers
- Visibility to customers
- Having good pedestrian flow (the number of potential customers passing by during business hours)
- Adequate parking (makes shopping convenient and accessible)
- Number of competitors nearby
- Expansion potential
- Economic climate of the trading area
- Future plans to the area

Case Study: McDonald's



McDonald's is all about location, location, location.

As one of the oldest franchise businesses and most recognisable business logos worldwide, McDonald's now has approximately 38,000 retail outlets globally. Why? Because the relative ease to finding a McDonald's restaurant is just around the corner. However, there is more to the McDonald's golden arches locations than you think.

McDonald's franchise agreement stipulates franchise location requirements including customer convenience, product familiarity and competitive prices. They understand that the chosen franchise location is a major part of the outlet's potential success. Stand-alone outlets must choose a location that maximises visibility and street exposure; that is, a corner location with signs visible from two major streets or a location near a major intersection with traffic signals is ideal. Ample parking is also required. Additional facility considerations are also specified in the business agreement including seating area, drive-through requirements, toilets and play space. McDonald's headquarters must approve the chosen franchise location and reserve the right to find alternate locations if franchise requirements are not met.

■ Goods and/or services

Vital to any business is knowing what the product is that the business is selling. Business owners want to create a competitive advantage over their competitors and differentiate their goods and/or services through effective operational and marketing strategies. Developing a good brand reputation and customer loyalty is key to developing repeat business.

■ Price

Pricing is a very important decision entrepreneurs must make. Prices that are too high can drive customers away. Prices that are too low reduces profitability and may leave the customer with the impression that its products and or services are of inferior quality. Determining the most appropriate price requires entrepreneurs to consider:

- the total cost of producing the product or service
- the pricing of competitors and their competitive behaviour
- the perceived price quality interaction of the product or service
- market demand for the product or service
- desired image for the product or service

f) Finance

Depending on which establishment option an individual decides is the best business option for them will influence the availability, the source and cost of finance the business can access. Finance is the money that a business uses to fund its activities. Debt finance and equity finance are the main sources available to small to medium enterprises. Each source has their own advantages and disadvantages of use.

■ Debt Finance

Debt finance refers to using funds borrowed by the business through external financial institutions like a bank. Debt finance must be repaid including the principal finance amount plus interest. It can be considered short term or long-term debt finance. Examples of short-term debt finance include credit cards and overdrafts and long-term debt finance include mortgages and term loans.

Advantages and Disadvantages of Debt Finance

Advantages	Disadvantages
<ul style="list-style-type: none"> ■ Debt finance is often easier to obtain and quick to fund if credit history or track record is used ■ No loss of ownership by using debt finance. Therefore, owners retain all business control in decision making process ■ Interest payments are a tax deduction 	<ul style="list-style-type: none"> ■ Limited track record or poor credit history will impact the business' ability to borrow funds ■ Interest payable makes debt finance costly ■ Debt repayments can add to financial pressures of new business owners

■ Equity Finance

Equity finance refers to the capital contributed to the business by owners. Upon establishment, an owner might contribute personal savings as equity finance or sell shares in the business. The capital contribution by each owner or shareholder gives them the right to a percentage share of the profits of the business and a 'say' to how the business will be run by management. Profits are paid out to each owner or shareholder in the form of a dividend. A dividend is a percentage return on the owner or shareholders invested capital.

Advantages and Disadvantages of Equity Finance

Advantages	Disadvantages
<ul style="list-style-type: none"> ■ Does not require repayment within a certain period; nor with the same burden that debt must be repaid. ■ The rate of return on investments paid to owners or shareholders is generally lower than that of debt holders ■ Equity finance technically means no money is owing as there is no loan to pay off. This reduces stress on management regarding cash flow and having money to pay off loan when contractually obliged. 	<ul style="list-style-type: none"> ■ Owners or shareholders share their percentage owner in the business. If one owner or shareholder holds more equity in the business; this equals greater managerial control in the decision-making process. ■ Dilution of ownership occurs when current owners or shareholders decide to find more equity finance. Not all owners or shareholders might approve of this. ■ Direction and choice of business is reduced based on owners and shareholders' investment (therefore ownership). This ownership controls the management of the business and its decisions.

■ Cost of finance

The cost of finance is usually considered as the interest (or fees) charged for using the chosen source of finance (that is, debt or equity finance).

In terms of debt finance, the cost of finance is interest. Interest is paid on top of the principal financed amount. Interest is calculated when the financial institution considers the level of risk involved the lender is taking. Without a credit history, a business and/or business owner can be considered high risk and therefore the cost of finance will be high. This means that the interest payable is at a higher interest rate. If you are a business and/or business owner with a credit history, upon a financial assessment, you will be considered of less risk and therefore the cost of finance will be less.

The cost of finance is also dependant on the length of time the finance is required for. This is referred to as the term of the finance and can be either short-term or long-term. Short-term finance is usually paid off in less than one year and has a higher interest rate attached to it. Whereas, long-term finance is paid back over a longer amount of time, that is, more than a year. The interest payable on long-term loans is charged at a lower interest rate as it can have a term of up to 25 or 30 years, like a mortgage. Long term loans are usually secured over the assets of the business.

In terms of equity finance, the cost of finance is paid in the form of dividends as a return to the owners and shareholders when profits are made at the end of the financial year. No interest, as such, is charged because this type of finance is owner/shareholder invested. If a profit is not made, a return on their investment is also not made.

g) Legal

Failure to comply with legal requirements when establishing a small to medium enterprise is against the law and can result in heavy fines. Every business must fulfil all legal obligations irrespective of cost and make the appropriate allowances to ensure their business is legally compliant. Registering a business name, zoning, taxation, health and other regulations are some of the key legal influences. Local, State and Federal governments and their agencies are responsible for imposing such legal regulations.

■ Business Name

In Australia, all businesses must register their business name with the Australian Securities and Investments Commission (ASIC). Except where the name of the owner is that of the business name; then this registration is optional. When a business name uses the owner's name but adds other words like 'Pty Ltd', 'and Co.' or words describing the business' purpose like 'Gardening' or 'Accounting', the business name must be registered. ASIC monitor business name registrations and prohibit more than one business registering the same business name. All businesses must also trade with an Australian Business Number (ABN) for taxation purposes.

Trademarks can also influence business name registration. For the purposes of legal protection, some businesses choose, through IP (Intellectual Property) Australia, to register as a trademark under the Trade Marks Act 1995.

■ Zoning

Zoning occurs to permit and prohibit land uses through dividing land into zones including residential, commercial, industrial and mixed zoning. When establishing a business, the owner must know the proposed business location's zoning as this will affect the business' operations and trading regulations. The local council determine the zoning areas and are the enforcing legal authority if any complaints are made by individuals or other businesses.

■ Health Regulations

The NSW Food Authority, also referred to as the 'health inspector', administers and enforces state and national laws regarding food safety, handling and preparation and the protection of consumers and their health. Each local council ensures that all businesses (particularly those preparing food for sale including cafes, restaurants and bars) understand the requirements and basic standards that must legally be met to operate. The health inspector can enter any business premises and conduct (routinely or randomly) health inspections. If the minimum requirements and basic standards of the Food Standards Code and the Food Act 2003 (NSW) are not met, businesses will face warnings, fines and possible closure.

■ Other regulations

It is vital that business owners remain up to date with all other regulations and legislation that affect their business' operations. One of these pieces of legislation is the *Competition and Consumer Act (CCA) 2010 (Cwlth)* and is enforced by the Australian Competition and Consumer Commission (ACCC). Designed to protect both consumers from undesirable practice like misleading and deceptive advertising and to regulate trade practices, the CCA affects all businesses marketing and business practices. Breaches of the Act by business owners can attract ACCC warnings with media release and/or fines (\$220,000 for individuals and up to \$1.1 million for companies).

h) Human Resources

Human Resources is said to be the 'face' of the business. For this reason, hiring the 'right' people in your business is key to the successful establishment and running of any small to medium enterprise. Any business and its owners must consider the following regarding their human resources;

- Number of employees needed
- Skill set required
- Employee roles and responsibilities
- Training and development for employees and management
- Minimum pay rates and/or remuneration packages

■ Skills

When establishing a new business, finding the most suitable and most qualified person for the job can be challenging although vital to surviving the business' establishment phase. Highly skilled and experienced employees are proven to be more productive and bring wealth, in the form of sales, to the business. These employees help to develop the business' reputation and create repeat clientele. For this reason, finding the right person for the job is critical. However,

not all potential employees will have all the required skills upon hiring. This is where training is important. Training can be both on the job and/or off the job training. It can be run by someone within the business or an external trainer can be used. Training aims to provide an employee/s or employer with the information and practice to improve their existing skill set.

■ **Costs – wage and non-wage**

The total cost of an employee is more than just their wage or salary. Often referred to as on-costs, these costs are additional to an employee's remuneration and can add 30-40% more business costs to the expenses of maintaining an employee. Common on-costs include:

- Superannuation (money that an employer to help support their employees financial needs when they retire.)
- Sick and carers leave (paid leave to help employees deal with personal illness, caring responsibilities and family emergencies).
- Long Service Leave (is a period of paid leave a worker can take after working with the same employer for an extended period)
- Annual leave (also known as holiday pay allows an employee to be paid while having time off from work)
- Holiday leave loading (an extra payment employees may be entitled to on top of their usual leave pay)
- Workers' Compensation (insurance payment to employees if they are injured at work)

These on-costs are considered employee benefits and may be part of legislation in the employment contract or offered by the employer as an incentive to maximise their output and efficiency. For example, by law, all full time employees are entitled to 4 weeks paid holiday leave a year, 10 days of paid sick and carers leave each year, and compulsory superannuation contributions (currently 9%) paid to their nominated superannuation fund. All businesses must insure their employees against accidents, illnesses and injuries in the workplace and must be covered by worker's compensation.

i) Taxation

In Australia, we rely on the government to provide us with a wide range of public goods and services. In order to pay for these, the government needs to collect taxes. Taxation (Tax) is a compulsory monetary contribution of earnings to government imposed on individuals, property, businesses and goods. Tax is collected by the three levels of government; federal and state governments and local councils. The Australian Taxation Office (ATO) is the Government's revenue collection agency who manage and enforce taxation requirements. Tax impacts the establishment of small to medium enterprises as the business owners must meet appropriate tax requirements to remain legally compliant. When any business starts to (and continue to)

operate, owners must manage their tax obligations as an ongoing concern. The following taxes commonly affect businesses. Some of the taxes levied by the Federal and State government and local councils are shown in Figure 38.

Figure 14: Federal, State and Local taxes

Taxation	Levied by
Income Tax – Pay As You Go (PAYG) <ul style="list-style-type: none"> ■ Paid by the employees ■ Collected and sent to the ATO by the business 	Federal Government
Goods and Services Tax (GST) <ul style="list-style-type: none"> ■ 10% ‘value added’ charge ■ Paid on most goods and services sold or consumed in Australia 	
Company Tax <ul style="list-style-type: none"> ■ Tax paid on profits made by companies ■ Profits are calculated after all deductions have been made ■ Calculated at 25% (for companies aggregated turnover less than \$10million a year) 	
Capital Gains Tax <ul style="list-style-type: none"> ■ Calculated on profits on selling assets such as real estate, shares or managed fund investments 	
Stamp Duty <ul style="list-style-type: none"> ■ Paid on documents when transferring ‘duty’/ownership of a sold asset like property or land. 	State (NSW) Government
Payroll Tax <ul style="list-style-type: none"> ■ Calculated on the wages paid or payable to employees by an employer when taxable wages exceed \$750, 000. ■ In NSW the payroll tax rate is 4.85% 	
Council Rates <ul style="list-style-type: none"> ■ Based on the value of land owned ■ Rates revenue collected is spent on community services and facilities including sporting and recreation services, waste collection treatment and disposal, public health and environmental planning and protection. 	Local Government

Exercise 3.3 Matching

Match the definition with the correct term below.

1. Someone who assumes the risk of starting a business based on the development of a business idea in the attempt of making a profit.	
2. The capital contributions to the business by the owners.	
3. The division of land in to uses.	
4. The monies borrowed from an external financial institution.	
5. The monies collected by the ATO as a compulsory contribution of earnings imposed on individuals, property, businesses and goods.	
6. The people of the business hired by management.	
7. Payments for non-wage benefit.	
8. Federal government scheme that requires financial contributions made by the employer to a fund set up for an employee's retirement.	
9. An individual or business that sells the rights to open a franchise.	
10. An individual or business that purchases a franchise.	

Work Bank: Debt Finance, Entrepreneur, Equity Finance, Human Resources, Taxation, Zoning, Superannuation, Franchisor, Franchisee, On-costs

3. The Business Planning Process

The process of business planning is key to business success. It is often said that 'businesses do not plan to fail; they fail to plan.' For this reason, SME owners need to have a good understanding of the role and process of business planning.

A business plan is the 'road map' for future growth and development within a business. It sets out the desired goals and direction of the business. It is a summary and an evaluation of a business idea in written form. The business plan gives purpose and direction to the business owners and management and can be easily shared with any of the business' stakeholders.

The process of writing a business plan can be incredibly time consuming. However there is no substitute for a well-prepared business plan and there are no shortcuts to creating one. When done properly, a business plan becomes an integral and natural part of the business planning process. Business planning is an ongoing activity. Business plans need to be reviewed regularly and updated especially whenever circumstances change.

a) Sources of planning ideas

The research and development of any business idea requires information from a range of sources. These sources assist in the business planning process and the creation of a comprehensive business plan. The business owners should look at both the internal business environment and the external business environment for such information.

Internal business environment – those influences or factors a business and their owners have some control over within the business. The business can plan and implement appropriate planning ideas proactively (see Topic 1; ‘Influences in the business environment’ for more detail).

External business environment – those influences or factors a business and their owners have little control over outside of the business. The business must preemptively plan and implement planning ideas; although must be reactive as necessary (see Topic 1; ‘Influences in the business environment’ for more detail).

■ Situational Analysis

An acronym for strengths, weaknesses, opportunities and threats; a situational analysis (or SWOT analysis) is an effective planning tool which analyses a business’ internal and external business environment. Often written in a summary table form, a situational analysis gives business owners a breakdown of what the business has full control over (internal business environment) and what the business must be reactive to (external business environment).

- Strengths are positive internal factors that contribute to the success of the business
- Weaknesses are negative internal factors that inhibit the success of the business
- Opportunities are positive external options that the business can exploit
- Threats are negative external forces that hamper the business

Figure 15: Situational Analysis Template

<p>Strengths</p> <ul style="list-style-type: none"> ■ Things that set you apart ■ What your customers love most ■ Competitive strengths and advantages ■ Unique capabilities, resources, assets and people 	<p>Weaknesses</p> <ul style="list-style-type: none"> ■ Things you should improve (outdated resources, obsolete technology, weak management, inadequate finances etc) ■ What do your competitors do better than you ■ Negative opinions about your business (top customer complaints)
<p>Opportunities</p> <ul style="list-style-type: none"> ■ Unexplored niches ■ New trends (market developments), openings in the market ■ Emerging innovations and technologies ■ Alliances 	<p>Threats</p> <ul style="list-style-type: none"> ■ New or existing competition (competitive intentions) ■ Negative government policies and regulations ■ Downturn in the economic cycle ■ Social changes that could threaten the business ■ Innovations in technology that could replace what you do

b) Vision, goals and/or objectives

■ Vision

A business' vision (or mission) is a statement that clarifies the business' aspirations and purpose. It is an expression of what entrepreneurs believe in and the values (principles that form the foundation of the business) on which they build their business. A clear vision statement should be concise, creative, focused and realistic. A clearly defined vision helps the business:

- Provide direction (sets the tone and determines the path the business will take)
- Guides the decisions the business makes
- Motivates employees and customers

■ Business goals

Goals (sometimes referred to as objectives) is something a business (and/or individual) wants to achieve. Goals should be realistic and specific and assist to fulfil the business's vision. Business goals are measurable against time frames:

1. Operational objectives – short-term/day to day goals
2. Tactical objectives – mid-term/months
3. Strategic goals – long-term/years

Goal setting is invaluable to motivating and keeping the owners, management and employees accountable. A business usually divides their goals broadly between financial goals, social goals and personal goals.

- Financial goals can include maximising profit, increasing market share, growth/diversification and share price.
- Social goals can include community benefit like community service, provision of employment, social justice and ecological sustainability.
- Personal goals can include individual preferences like job promotion, higher income and undertaking (re)training and development courses.

■ Long-term growth

Growth is the increase in size and value of the business. Growth requires business owners to plan strategically and proactively organise the business resources in a way that matches the direction of the business and ensures that a competitive advantage is sustained. It is important for management to identify growth opportunities and develop strategies accordingly that will help achieve the business' goals. Ultimately, all businesses aim to achieve profit maximisation as their strategic goal (that is, in the long term). Increasing sales, market share and profits are other business goals that will contribute to the business' overall growth. Some strategies a business will utilise to achieve long term growth include:

- Lean manufacturing and production
- Customer feedback
- Product modification and innovation
- Supply chain management
- Utilising latest technology
- Outsourcing

c) Organising resources

The next step of the business planning process is organising resources within the business to ensure the business plan is put into action. The organisation of resources including owners, management, employees, time, finances (money), materials, equipment and facilities are key to ensuring the business operates. This is a collective effort and must be achieved throughout all four key business functions (Operations, Marketing, Finance and Human Resources) of the business. The key business functions are interdependent of one another and must work together to achieve the business goals (see Topic 2; 'Management Processes' for more detail).

■ Operations

Operations is when a business uses its inputs and transforms them into their outputs. Therefore, organising the resources of the operations function (that is, operations management) is necessary to ensure efficiency in providing the business' outputs (the goods and/or services).

Note: the inputs (otherwise the resources) include ideas and information, raw materials, labour and capital equipment, machinery and technology.

■ Marketing

Marketing is the coordination of bringing the buyer and seller together in an effort to satisfy the customer's needs and/or wants. The main role of the marketing function is to plan and organise the marketing strategies in line with the business's strategic (long term) goals. The marketing strategies a business uses can vary but stem from the marketing mix (that is, product, place, price and promotion). It is therefore, the marketing function which aims to persuade, remind and inform the consumers about the good and/or service the business sells, for how much and where they can buy the product.

The result = increase sales, increase market share, develop customer loyalty and in turn to maximise the business's profits (see Topic 2; 'Management Processes' for more detail).

■ Finance

Organising a business's finances is key to their survival but is a major source of stress for all business owners. Financial resources are anything within a business of monetary value including capital, money, equity, assets and debt management. Therefore, financial management aims to plan and monitor all of a business's financial resources in an attempt to achieve its financial goals.

These financial goals will include profitability, growth, efficiency, liquidity and solvency. The aim of financial management will align with the overall business's goals, both in the short term and long term (see Topic 2; 'Management Processes' for more detail).

■ Human Resources

The term human resources refer to the persons (or employees) within a business. The organisation and management of this resource can be challenging as the business owners need to maintain a balance between achieving the business's goals of increasing sales and maximising profits and ensuring staffing needs are met (inclusive of legislative requirements). The main functions of human resources are to attract and acquire, train and develop, reward, maintain, and separate the people of the business. A business is, therefore, looking for employees that are 'the right person with the right skills'. These employees help to develop the business' reputation and create repeat clientele (see Topic 2; 'Management Processes' for more detail).

Exercise 3.4 Matching

Match the following 5-point summary to each of the correct terms below.

Business Function/ Resource	5-point summary
1.	<ul style="list-style-type: none"> ■ Inputs ■ Transformation process ■ Outputs ■ Goods and/or services ■ Materials, labour and technology
2.	<ul style="list-style-type: none"> ■ 4 P's ■ Strategies to bring together buyer and seller ■ Persuade, remind and inform ■ Aims to increase sales, increase market share ■ Develop customer loyalty
3.	<ul style="list-style-type: none"> ■ Capital ■ Debt ■ Equity ■ Asset management ■ Profitability, liquidity, solvency
4.	<ul style="list-style-type: none"> ■ Employers ■ Employees ■ Acquire, train, develop, maintain and separate ■ Remuneration package ■ Management

Work Bank: Finance, Human Resources, Marketing, Operations

d) Forecasting

Forecasting is a quantitative planning tool a business can use to project and predict the future. Forecasts can be made about all key business functions; however, most businesses focus on forecasting their finances in the business planning process. Predictions will be made about a business's total revenue (and sales), their total costs, when the business will break-even and what the cash flow in and out of the business might be. A business will look at business trends and make predictions based on past and present data, when available. Similar businesses within the industry might be used as a guide if no track record or trading history is available.

■ Total revenue, total cost

SME owner/s must try to forecast the business's potential sales (total revenue), and the expected expenses (total costs) for a specific period.

Total revenue is the total money that is generated from the sales of the business's goods and/or services. Total revenue is calculated by multiplying the selling price of the good and/or service by the number of units sold.

Total Revenue = Selling price/unit x Units sold

For established businesses the total revenue (sales) forecast can be based on past sales. Other factors to consider include current economic conditions, market growth (external) and marketing efforts and price changes (internal).

Total cost is the total money involved in running the business. Costs are categorised into fixed costs and variable costs. Fixed costs are costs that do not vary with changes in the volume of sales or production. Examples of fixed costs include rent, salaries and insurance. Whereas, variable costs are costs that do change dependant on production levels and units produced. Examples of variable costs include raw materials, hourly wages and electricity. Total costs can be calculated by adding fixed costs and variable costs together.

Total costs = Fixed costs + Variable costs

Therefore, when a business forecasts their total revenue and total costs, it will allow the owners to generate a break-even analysis. This forecasting tool can assist the owners in the planning process and predict at which point in their production, they should break-even and begin to generate a profit.

■ Break-even analysis

A key component of a business plan is breakeven analysis. In business, to break-even is when total revenue equals total costs. That is, that level of operation where all costs (fixed and variable) are covered by sales but no profit has (yet) been made. Break-even analysis shows

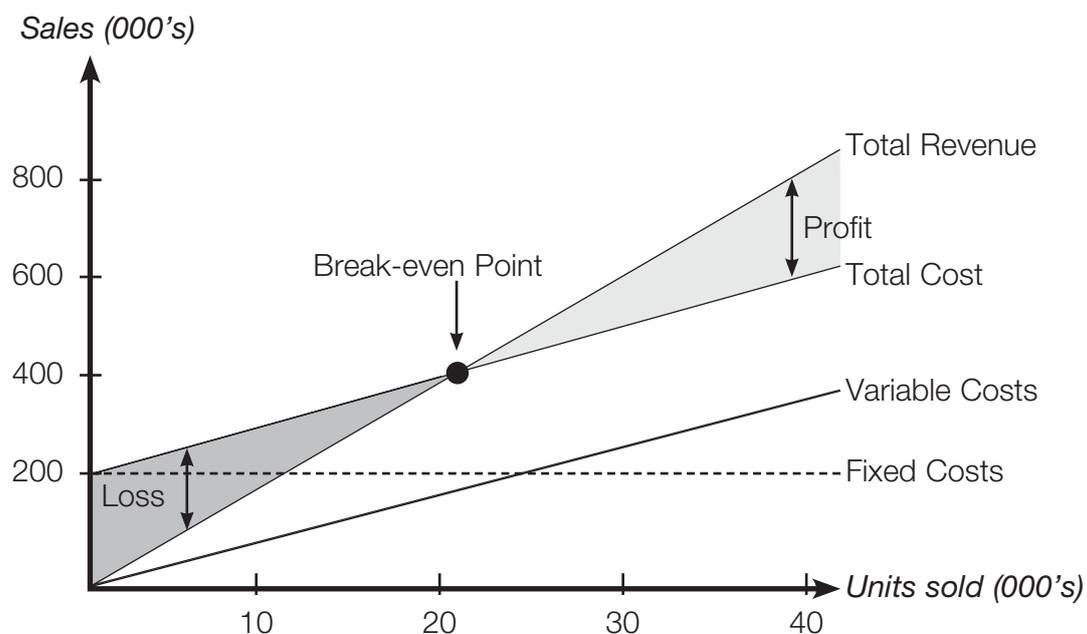
the interrelationships among a firm's sales revenue, cost, and profits as they relate to alternate levels of output.

Break-even analysis:

- Enables the entrepreneur to determine the minimum level of activity required to keep a business in operation and or the sales necessary to generate a desired level of profit.
- Helps in budgets and setting realistic targets
- Shows how changes in costs affect the break even point and therefore profitability
- Helps device a pricing strategy because if the selling price is reduced a business needs to sell more to break even.

Break even analysis can be calculated graphically and mathematically.

Figure 16: Break-even analysis Beyond Beauty Moisturiser



- Fixed cost is a straight line parallel to the horizontal axis (remains constant at \$200000 for all levels of activity)
- Variable cost is a straight line sloping upwards as output increases
- Total cost is a straight line sloping upwards beginning at the point at which the fixed cost line intersects the vertical axis (adds the variable cost and fixed cost lines together)
- Total revenue is a straight line sloping upward from zero (every unit of output contributes a constant amount to total revenue)
- The break even point is the intersection of the total cost and total revenue lines, 20000 units sold with a value of sales of \$400000.

- Operate at a sales volume to the left of the break even point (sell less than 20000 units) and the business will make a loss because the total cost line is above the total revenue line.
- Operate at a sales volume to the right of the break even point (sell more than 20000 units) and the business will make a profit because the total cost line is below the total revenue line.

Mathematically the breakeven point in units can be calculated by the formulae:

$$\text{Breakeven Output} = \frac{\text{Fixed Costs}}{\text{Selling Price} - \text{Variable Cost per Unit}}$$

Using our example if Beyond Beauty Moisturiser sells a bottle of moisturiser at \$20, fixed costs are \$200000 and variable costs per unit are \$10, the number of units required to be produced and sold to break-even is 20000 units.

$$\begin{aligned} \text{Breakeven Output} &= \frac{200000}{\$20 - \$10} \\ &= 20000 \text{ units} \end{aligned}$$

Mathematically the breakeven point in units can be adjusted to meet a certain profit level by the formulae:

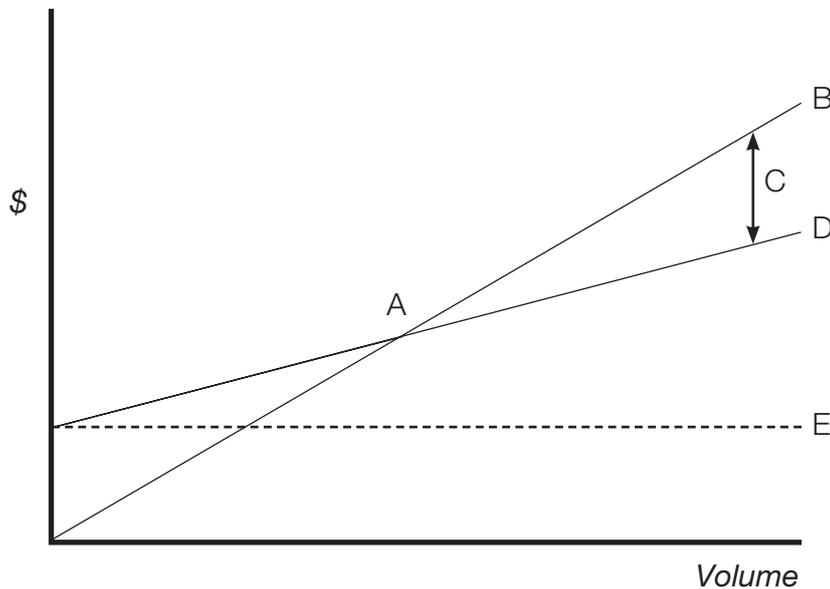
$$\text{Breakeven Output} = \frac{\text{Fixed Costs} + \text{Desired net profit}}{\text{Selling Price} - \text{Variable Cost per Unit}}$$

Using our example if Beyond Beauty Moisturiser wishes to generate a profit of \$100000 sell the number of units required to be produced and sold to meet this target is 30000 units.

$$\begin{aligned} \text{Breakeven Output} &= \frac{200000 + 100000}{\$20 - \$10} \\ &= 30000 \text{ units} \end{aligned}$$

Exercise 3.5 Matching

Use the following graph to answer the question below.



Match which letter correctly identifies each of the following on the break-even graph.

1. Fixed Costs	
2. Break-even point	
3. Total Revenue	
4. Profit	
5. Total Costs	

■ Cash flow projections

Cash flow and profit are not the same. Profit is the difference between total sales and total expenses. Cash flow is the money that readily available to use in the business (flow of cash in and out of a business). A business must have enough cash to pay its short term obligations (liquidity) or it will be insolvent. Usually there is a time lag between paying suppliers and receiving payment from customers. Purchases for inventory and production typically must be paid before sales are generated. As well collection of accounts receivable lags behind sales. Customers who purchase on credit usually pay a month or more later.

This uneven flow of cash creates periodic cash shortages and SME owners need to prepare a cash flow projection (budget) which forecasts future cash flow. Most businesses use a month by month cash flow projection as seen in Figure 42 below. It is important to note that negative

cash amounts can be shown in the budget as a minus amount with a – or using brackets around the (cash amount). Ultimately, in periods of high cash inflows, the business must save some cash for when the business will experience periods of high cash outflows (including rent, insurance or other expenses fall due).

Figure 17 Example of Cash Flow Forecast

	Sep	Oct	Nov	Dec
CASH INFLOW ← Cash Inflow – Money coming in				
Cash Sales	6000	6500	8000	11000
Credit Sales	2000	3000	3500	4000
Total Cash Inflows ← Cash Outflow – Money going out	8000	9500	11500	15000
CASH OUTFLOW ←				
Materials	2500	3500	3600	5600
Wages	4000	4000	4000	4500
Other Overheads	1400	1500	1500	2100
Total Cash Outflows ← Net Cash-flow – Difference between TCI and TCO	7900	8900	9100	12200
Net Cash Flow ←	100	600	2400	2800
Opening Balance	800	900	1500	3900
Closing Balance	900	1500	3900	6700

Closing Balance –
Add opening balance and net cash flow

Opening Balance –
What is left from previous month

Opening Balance –
Closing balance from previous month is carried over

Exercise 3.6 Cash Flow Projection

Lily's Ice Creamery plans to open a second shop in preparation for the summer of 2020. Lily anticipates the second shop will be very busy. Although she is concerned about the cost involved with setting the shop up before having an established customer base. She has asked you to complete a cash flow projection using the information given.

Complete the following table.

	June	July	August	Sept	Oct	Nov
Total cash inflows	9 000	7 000	8 000	11 000	11 000	14 000
Total cash outflows	6 000	7 000	20 000	15 000	10 000	11 000
Net cash flow	3 000					
Opening cash balance	5 000					
Closing cash balance						

Exercise 3.7 Multiple Choice

Select the alternative A, B, C or D which best answers the question based on Lily's Ice Creamery's Cash Flow Projection.

1. What is the purpose of a cash flow projection?
 - A. To assist the business in forecasting its cash flow (that is the cash inflows versus cash outflows)
 - B. To complete legislative requirements for the Australian Taxation Office (ATO)
 - C. To determine what sales the business has had in the last 6 months
 - D. To generate a cash surplus

2. What is the closing cash balance for the month of October?
 - A. \$7 000
 - B. \$8 000
 - C. (\$7 000)
 - D. (\$8 000)

3. In which month/s is it forecasted that the business will have a cash deficit?
 - A. July and July
 - B. August and September
 - C. September, October and November
 - D. August, September, October and November

4. Which strategy would be most appropriate for Lily to solve her liquidity problem?
 - A. Obtain a bank overdraft
 - B. Hire more staff
 - C. Introduce a customer loyalty rewards card
 - D. Not pay her suppliers

5. What would be the most likely reason for Lily's cash outflows increasing during August and September?
 - A. Lily had more sales
 - B. Lily has less staff working these months
 - C. Lily decided to buy more stock
 - D. The rent payable was higher in these months

e) Monitoring and evaluations

A business plan is said to be the 'road map' to assist with a business's success. However, a business plan must evolve with a business and it is important that the business plan be continually monitored and evaluated to ensure its as current and up to date as possible. All business owners must consider the ever-changing business environments and take corrective action by implementing appropriate modifications when they see necessary. In business,

- to monitor means to check business performance by comparing actual performance versus planned performance. Whereas,
- to evaluate means to investigate business performance and the difference between the actual and planned performance and to make judgements based on whether the business has achieved their business goals.
- A business can use a range of planning tools to monitor business activities including sales reports, budgets and profit comparisons.

■ Sales

A business generates income through sales. Therefore, a business must forecast, monitor and evaluate sales made by the business in a time period to best understand their sales performance. A sales report is a planning tool that most business's produce to assist owners in the monitoring and evaluating of both cash and credit sales. When, for example, a new product is released or a new marketing campaign has been launched, it is advantageous for business owners to monitor what happens with sales in this time period. By comparing actual sales performance with planned sales, the business can evaluate whether sales were higher or lower than what was forecast. A business must take corrective action when sales prove to be lower than what was forecast.

■ Budgets

A budget is an estimate of a business's revenue and expenses over a period of time. Used in the process of monitoring and evaluating a business's financial plan, a budget is a planning tool that quantifies the facts and figures about how a business's financial resources will be used with the foresight of achieving business goals. A business can compare actual figures with the estimated figures of the budget, monitor progress, and/or assess problem areas to implement cost controls where necessary. From here, corrective action can be taken by updating budget forecasts based on new financial projections.

■ Profit

Profit is the money which the business gets to keep after all expenses have been taken out. All businesses aim to make a profit and therefore, it is the main financial objective and strategic goal in business. Businesses use profit as a benchmark of business performance. To ensure a profit is made, a business needs to maximise products sold as sales and minimise their operating costs as much as possible. Forecasting sales and creating budgets

is a part of the financial planning process that allows business owners to monitor and evaluate the business profits and take corrective action when profits are not achieved.

f) Taking corrective action

Actual performance rarely, if ever matches plans exactly. Taking corrective action is when the entrepreneur decides on the actions required to correct performance that deviates from the business plan. Corrective action is based on the information collected in the monitoring and evaluation process and is the last step in the business planning process.

Figure 18: the business planning process



Taking corrective action can involve changes to management processes, the goods and/or services sold themselves and their production, how the product is marketed, providing staff with additional training, improving inventory control, tightening or budgetary updates.

4. Critical issues in business success and failure

A business's success and failure can be a result of a number of factors. With careful planning and responsive management, failure can be avoided, and success achieved.

a) Importance of a business plan

The business plan is a written summary of the entrepreneurs proposed business venture. It describes the direction the business is taking, what its goals are, where it wants to be and how it is going to get there. Writing a business plan may appear to be overwhelming and some business owners launch their business with a see what happens approach. However studies show that owners who invest their time and energy into developing a comprehensive business plan have a much greater chance of business success.

Business Plans are important because they:

- Force entrepreneurs to evaluate their business ideas in the harsh light of reality (more objectively)
- Help the business owners prioritise the goals and the strategies to achieve them.
- Provide managers and employees with a clear sense of direction. The planning process allows all owners, management and employees to become and harnesses their strengths

and experience. It keeps everyone on the same page.

- Assist in obtaining finance (attract lenders and investors). A well-developed business plan shows how serious you are about the business, helps lenders and investors understand your business idea and shows predicted income and profit margins.

Every business plan is unique and must be tailor made however there are some standard elements in a business plan.

Business Plan Template

1. Executive Summary – the business at a glance including subheadings:
 - Business name, ownership, purpose, vision, short-term and strategic long-term goals, overview of businesses goods and/or services
2. The business in detail including subheadings:
 - History, SWOT analysis, competitive analysis, management team, licences, registrations, permits and insurance (risk assessment)
3. Goals, milestones and strategies including subheadings
 - Marketing: goals, target market, market research, pricing and promotional strategies, distribution systems
 - Operations: location, facilities, technology, equipment and major suppliers
 - Human Resources: Staff needs, managing employees (rewards, training)
4. Financial plan including subheadings:
 - Set-up costs, financing, income and expenses forecast, cash flow forecast, balance sheet forecast, break-even analysis, credit management
5. Supporting documentation

b) Management – staffing and teams

As the business grows, the entrepreneur must relinquish control and learn to depend on the productive energy of others to achieve results. Critical to business success is the individuals that work within any business. Referred to as the human resources, it is a key business function that is a coordinated effort of owners, management and employees to achieve the business's goals.

Finding the right people with the right skills for a job means that the business runs in an efficient and effective manner. Managers must be multiskilled and understand an owner's vision. They must have the ability to turn this vision into a reality with satisfied and motivated staff who are as productive as they can be to help the business succeed.

It is the employees who are often the face of the business and provide the competitive advantage in a service-based business where the customer and staff have direct interactions.

Businesses are increasingly relying on teams of employees rather than individuals to complete business activities. Work teams are groups of employees that work together semi autonomously on a task. Businesses that use teams effectively report significant gains in creativity, quality, increased customer satisfaction and improved employee motivation and morale. However, it can be challenging to find the right combination of staff to work together in teams and for this reason, external recruitment, professional training and coaching services can be utilised to boost team building and skill development.

c) Trend analysis

A critical issue in business is understanding and managing a business's performance. To combat this, an effective and efficient business owner will forecast, monitor and control performance using trend analysis. Trend analysis is the process of tracking business information to identify patterns and understand changes over time.

A business owner will forecast business performance including sales, revenue, operating costs and profits amongst other benchmarks. A business can track performance, identify patterns that emerge and then can modify strategies and take corrective action to achieve business goals.

d) Identifying and sustaining competitive advantage

For any business to be successful, a competitive advantage must be identified and sustained, one that gives value for customers and is difficult for competitors to duplicate. A competitive advantage is the accumulation of factors that sets the business apart from its competitors and gives it a unique and superior position in the market. The business plan can be used to document strategies that gain a competitive advantage. These strategies include:

- Price/cost strategy – when the business uses efficient production processes, technology and lower cost labour to minimise the costs involved in making the product. In return, the business can charge a lower sale price for the product to their customers in the hope of maximising sale volume.
- Differentiation strategy – when the business creates a product that is different from that of the competitors. The product might use innovation, invention, high quality inputs and/or offer additional services not already available by competitors.

Case Study: Kylie Jenner and Kylie Cosmetics

Just another cosmetic company? In 2015, a then-18-year old Kylie Jenner decided to start her own cosmetic company. Think lipsticks, lip liners, eye shadows and bronzers. In 2019, she sold 51% of her company for \$600 million. So, what's her competitive advantage?

175-million online followers and the power of social media.

Her marketing strategy has utilised her following on Snapchat, Instagram, Facebook and Twitter. She uses social media to announce product launches, previews new items and shares videos of her daily make up shades. She commented on her "strong reach" helping sales; her initial lip kits selling out online in less than a minute and when other Kylie Cosmetic make up kits were released, the website collapsed with too many users.



Kylie Jenner is the ultimate social media influencer and is not shy about flaunting her products across the Kylie Cosmetic Instagram account and her personal account. Her celebrity status comes from being the youngest member of the Kardashian-Jenner family; this being her differentiation strategy other business owners can dream of. As a result, the tv series, publicity, Kylie had already established her own brand before creating Kylie Cosmetics. She is very active on her Instagram stories which is reported to have more than 400 million daily active users; nearly all her stories are used to endorse products from kyliecosmetics.com. The product range is ever-expanding, and Kylie Cosmetic cleverly drives demand through releasing limited edition and holiday collection ranges. Most of her marketing and product purchases are because of this strategy. She makes an annual tradition of Valentine's Day, Halloween, birthday, winter holiday editions that sell within minutes. Fans are always left wanting more!

e) Avoiding over-extension of finance and other resources

Some businesses fail because they grow too fast, overspend and overextend themselves financially (take on too much debt without the capacity to repay). This makes the business particularly vulnerable in an economic downswing or when interest rates increase. The finances of the business need to be well planned using budgets to avoid overspending.

Finance is not the only area in which a business can overextend. A business can also over commit to resources (inputs necessary for a business to carry out its function) such as stock and staff.

Even though stock represents the potential for future profits, carrying too much stock results in the business incurring some serious and costly expenses. Carrying too much stock takes up valuable storage space. Overstocking also ties up cash that could be used for growing

the business, and when stock goes out of date or damaged it decreases in value. Inventory management techniques include accurate forecasting of demand, FIFO (older stock gets sold first) and cloud based inventory management software.

Having too many staff reduces profitability, staff motivation and productivity. Staff wages are one of the three largest expenses of business. Human resource forecasting and a clear organisational chart with clearly defined job functions can help optimise staff levels.

Case Study: Masters Home Improvement: Closed for business



Just when consumers thought the rivalry between supermarket giants, Coles and Woolworths, couldn't get any bigger, came Woolworth's inception of Masters Home Improvement back in 2009. With grand plans for Masters to overshadow Wesfarmers' Bunnings, some said they were set to fail from the beginning. Of the \$43 billion home improvement market, Bunnings already had 18% market share. Masters best market share percentage peaked at 2% during their short period of trading. The reasons behind their failure was ultimately the over-extension of finance mixed with poor business planning turned operation's strategy.

- Masters racked up combined losses of more than \$600 million, including an annual loss of \$245 million in 2015.
- Capital spending on the business, including finding sites and building the 63 stores, totalled more than \$3 billion.
- Masters admitted to selling the wrong products at the wrong time of year. They choose to sell whitegoods which meant a huge number of competitors in the domestic market yet ignored high-margin basic hardware including garden care and power tools.
- Often an operational strategy for retailers would see businesses choosing between quality sites, good value sites or do it fast – they can't have all 3. But Masters tried anyway attempting to mimic Bunnings geographical spread Australia wide in a very short space of time. Masters opened 63 stores in fast succession with the then-plan to roll out another 150 stores in five years. Compared to that of Bunnings with over 240 warehouses across Australia.
- Masters attempted to liquidate as many of the business' assets before they closed their doors including a fire sale on all stock, worth between \$600 million and \$700 million.

Woolworths then-CEO, Grant O'Brien made the reluctant decision to close the Masters chain in late in 2016. The original plan was to reach break-even point by 2016 and O'Brien justified the closure by saying "our ambition from the get-go was five years".

f) Using technology

Today, a business must utilise technology to stay competitive. Technology increases efficiency and minimises time delays that once existed. Businesses can utilise e-business (or electronic business) to streamline point-of-sale and other operational functions within a business; both automated and 24 hour a day. Sales can now be made over the phone or online via the business website or on social media and have next day dispatch or delivery. Machinery and equipment can be semi or completely automatic or robotic to complete the production process. Technology allows business owners to complete all legislative requirements and business to business transactions at the click of a button. If technology is not utilised, understood and managed then a business could face this as a critical business issue towards achieving business success.

g) Economic conditions

Changes in economic conditions can impact on business performance. Periods of strong economic activity can promote business success. Whereas, periods of weak economic activity can lead to business failure. For this reason, businesses must be proactive and reactive in their business planning to combat fluctuations in economic activity (that is, booms and busts) over any businesses trading periods.

Characteristically, changing economic conditions impact business activity in the following ways:

<p>In 'boom' periods or periods of strong economic activity:</p>	<ul style="list-style-type: none"> ■ The level of consumer spending is high as is consumer confidence. Consumers will purchase needs-based goods and services as well as purchasing luxury items with their disposable income. ■ There is falling unemployment as businesses have the capacity to hire more employees to meet growing demand for goods and services. ■ Total number of goods and services produced (production output) will increase to meet the growing demand by consumers. 	<p>Impact on businesses:</p> <ul style="list-style-type: none"> ■ Increased output ■ Increased sales ■ Increased profits ■ Need to recruit staff
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<p>In 'bust' periods or periods of weak economic activity:</p>	<ul style="list-style-type: none"> ■ The level of consumer spending is low as is consumer confidence. Consumers will purchase only needs-based goods and services. Budget and low-cost goods and services will sell most. ■ There is rising unemployment as businesses will retain current employees but cut hours of part time and casual workers. Employees can be made redundant dependant on the severity of a bust period. ■ Total number of goods and services produced (production output) will decrease to match falling demand by consumers. 	<p>Impact on businesses:</p> <ul style="list-style-type: none"> ■ Decreased output ■ Decreased sales ■ Decreased profits ■ Need to reduce staff
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Exercise 3.8 True or False

Indicate whether the following statements are true or false.

True/False Statement	True/False
1. It is the law that says all businesses must write a business plan.	
2. Once an employee gets a management position, they won't have to complete any further training.	
3. Trend analysis is to understand business information to assist in finding patterns and changes of business performance over time.	
4. Overcommitting to financial obligations in the start-up phase of a business is one of the main reasons for business failure.	
5. Fluctuations in economic activity can impact both positively and negatively on business performance.	

Exercise 3.9 Multiple Choice

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

1. A business plan:
 - A. Is a statement of goals for the business and the steps taken to achieve them
 - B. Is only prepared when a business is initially established
 - C. Allows stakeholders to determine the viability and profitability of the business
 - D. both (A) and (C)

2. Which of the following reasons is NOT a reason for business failure?
 - A. Competition with a similar product
 - B. Financial pressures
 - C. Flexibility
 - D. Mismanagement

3. Which of the following is true in the case of buying an existing business?
 - A. It is guaranteed to succeed
 - B. It involves a greater initial capital outlay than starting a business from scratch
 - C. Usually does not involve having to pay for the goodwill of the business
 - D. It does not involve working as hard as starting a business from scratch

4. Alexander is a small business owner who has failed at business once before. He has decided to risk his personal savings on opening a new business. He believes he is a problem solver with good communication. Which of the following personal qualities was NOT mentioned in the above scenario?
 - A. Cultural background
 - B. Motivation
 - C. Qualifications
 - D. Skills

5. Harry Candice has decided to start and operate his own lawn mowing business. He has decided to trade under the name Harry Candice Lawn Mowing. Which of the following statements is true in relation to Harry's desired business name?
 - A. He doesn't need to register it because it is mostly his own name
 - B. He doesn't need to register it unless he wants to
 - C. He needs to register the business name
 - D. He only needs to register it if he uses an accountant

6. Which of the following is a federal tax that is imposed on SME's
- A. Company Tax
 - B. Council Rates
 - C. Stamp Duty
 - D. Payroll Tax
7. A business is undergoing a SWOT analysis. Which of the following would it list as a weakness?
- A. Poor staff motivation
 - B. Aggressive marketing campaign from a competitor
 - C. New government regulations
 - D. Depreciating \$AUD
8. Barbara and Leon are looking to purchase the Bundaberg Barber Shop. The business has been running for 7 years. Which of the following best classifies this business?
- A. Existing
 - B. Franchise
 - C. New
 - D. Old
9. 'To use the same business idea under the exact operating business format including name, products and marketing' best describes which of the following establishment options?
- A. Existing
 - B. Franchise
 - C. New
 - D. Old
10. Which of the following shows the correct order of the steps in the business planning process?
- A. Forecast, Monitor, Evaluate, Modify
 - B. Forecast, Evaluate, Modify, Monitor
 - C. Modify, Evaluate, Monitor, Forecast
 - D. Monitor, Modify, Evaluate, Forecast

11. Which of the following correctly defines the term 'budget'?
- A. A broad, formal statement that outlines what a business stands for what it hopes to achieve
 - B. A document which sets out the business's financial and marketing objectives over a period of time
 - C. A financial tool used by a business to record the sales, costs and profits of a business
 - D. A plan of the revenue and expenses of a business over a future period of time

12. Which of the following is NOT a part of the business planning process?

- A. A situational analysis
- B. Establishing goals and objectives
- C. Monitoring and evaluating financial performance
- D. Preparing financial statements

13. A business can calculate their break-even point by using the following formula:

$$\text{Breakeven Output} = \frac{\text{Fixed Costs}}{\text{Selling Price} - \text{Variable Cost per Unit}}$$

If Fern Gully Florist sells their bouquets for \$40 each. It costs \$20 for the flowers themselves and the business has fixed costs of \$120 000. What is the break-even point for Fern Gully Florist?

- A. 1667
 - B. 2000
 - C. 6000
 - D. 6001
14. Which of the following would provide a business with a competitive advantage over its competitors?
- A. Economic boom, increased cash flow and greater sales
 - B. Greater sales revenue, lower prices and a bigger market share
 - C. Lower expenses, increased net profit and lower staff turnover
 - D. Lower prices, value for money and a differentiated product

15. Unemployment is set to rise, and total production output will decrease. Which of the following statements about the economic conditions on businesses is correct?
- A. There will be no change to business profits
 - B. The country will soon enter a period of stronger economic conditions that is likely to impact negatively on business' profits
 - C. The country will soon enter a period of weaker economic conditions that is likely to impact negatively on business' profits
 - D. The country will soon enter a period of weaker economic conditions that is likely to impact positively on business' profits

Exercise 3.10 (10 marks)

Denise has owned her florist in Bankstown for 15 years. She has one other full-time staff member and a trainee. Another florist has just opened in the same shopping complex.

- a) List TWO common characteristics used to classify small to medium enterprise. (2 marks)

- b) Describe TWO ways small to medium enterprises are important to the Australian economy. (4 marks)

- c) With reference to Denise's business, outline TWO reasons why her business could fail. (4 marks)

Exercise 3.11 (10 marks)

Sally and Julia want to open a new hairdressing business in Canberra. They both have hairdressing experience. Sally enjoys dealing with people and wants the business to be known for their customer service. Julia has personal savings to contribute to the running of their business.

- a) Identify ONE personal quality that Sally or Julia possess. (1 mark)

- b) Outline the THREE types of establishment options Sally and Julia can consider for establishing their small to medium enterprise. (3 marks)

c) Describe TWO finance options Sally and Julia can use to fund their business. (4 marks)

d) Explain ONE influence in establishing their small to medium enterprise (other than those identified in a), b) and c).) (2 marks)

Exercise 3.12 (10 marks)

Toni runs a family-owned vineyard in the Hunter Valley. She understands the importance of business planning. However, feels like the process is too time consuming.

a) Describe the role of a situational analysis in the business planning process. (2 marks)

b) Distinguish between operations and marketing when organising resources. (2 marks)

c) With reference to Toni's business, outline how monitoring and evaluation is an important part of the business planning process. (2 marks)

d) Explain TWO critical issues in business success and failure. (4 marks)

Answers to Exercises

Exercise 3.1

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

Exercise 3.2

A. Advantage, B. Disadvantage, C. Disadvantage

A. Advantage, B. Advantage, C. Advantage (if good location; Disadvantage if poor location)

A. Advantage (or disadvantage?), B. Disadvantage, C. Disadvantage

Exercise 3.3

1. Entrepreneur, 2. Equity Finance, 3. Zoning, 4. Debt Finance, 5. Taxation, 6. Human Resources, 7. On-costs, 8. Superannuation, 9. Franchisor, 10. Franchisee

Exercise 3.4

1. Operations, 2. Marketing, 3. Finance, 4. Human Resources

Exercise 3.5

1. E, 2. A, 3. B, 4. C, 5. D

Exercise 3.6

	June	July	August	Sept	Oct	Nov
Total cash inflows	9 000	7 000	8 000	11 000	11 000	14 000
Total cash outflows	6 000	7 000	20 000	15 000	10 000	11 000
Net cash flow	3 000	0	(12 000)	(4 000)	1 000	3 000
Opening cash balance	5 000	8 000	8 000	(4 000)	(8 000)	(7 000)
Closing cash balance	8 000	8 000	(4 000)	(8 000)	(7 000)	(4 000)

Exercise 3.7

1. A, 2. C, 3. D, 4. A, 5. C

Exercise 3.8

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

Exercise 3.9

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

Exercise 3.10

- a) Answers could include number of employees (1-200), legal structure (mostly likely sole trader or partnership), market share (small), sources of finance (majority equity financed before track record established to secure debt)
- b) Answers could include brings the buyer and seller together, GDP, employment, balance of payments, contribution to invention and innovation

Sample Answer: SMEs contribute significantly to the Australian economy. Small to Medium Enterprise create the goods and services for sale in local markets. Nationally, they produce approximately 50% of Australia's Gross Domestic Product (GDP). They also provide approximately 70% of employment in the private sector. This means that for the jobs that SMEs provide; they are giving their employees a wage/salary that supports other businesses when they use their income to purchase goods and services that satisfy their needs and wants.

- c) Answers could include financial pressures, lack of planning, information, experience or market knowledge, mismanagement, poor location, competition, economic downturn, new taxes

Sample Answer: Many SMEs end in failure and for a variety of reasons. One reason for failure is competition. Whilst competition is good for business, sometimes competition can become too much; notably when competing with big corporations. Denise has a new competitor in the same shopping complex.

Another reason for possible failure is financial pressure. She should forecast her income and expenses to help her stay on top of her finances. Denise has herself, a full-time staff member and a trainee. Denise needs to justify the costs associated with her staff and ensure that she has enough sales and capital to continue operating her business as it currently is and/or without financial pressures.

Exercise 3.11

- a) Answers could include qualifications, skills, motivation, entrepreneurship
- b) Answers could include new, existing, franchise

Sample Answer: There are 3 options to establishing a business.

Setting up a new business – starting from scratch. The owner controls all the decision making and has freedom to set up business where they wish. Often considered the riskiest.

Purchasing an existing business – less risky than setting a new business up. There is an existing image and business reputation with business name and customer base. Potentially minimal changes required.

Buying a franchise – under a franchise agreement, using an already established business concept, its name and product. Usually well known. However, they can be more costly to establish.

c) Answers could include equity finance and debt finance

Sample Answer: Sally and Julia can finance their business using equity finance and debt finance.

Equity finance is the capital contributed to the business by owners. Upon establishment, an owner might contribute personal savings as equity finance or sell shares in the business. Sally and Julia will need to consider if the savings that Julia has already saved is enough to start their business.

The other type of finance available to fund Sally and Julia's business is debt finance. It refers to using funds borrowed by the business through external financial institutions like a bank. Debt finance must be repaid including the principal finance amount plus interest. It can be considered short term or long-term debt finance. Examples of short-term debt finance include credit cards and overdrafts and long-term debt finance include mortgages and debentures.

d) Answers could include sources of information, the business idea, market, legal, human resources, taxation

Sample Answer: All SME owners must be aware of their legal obligations. Fulfilling these legal requirements can be costly. However, when businesses do not obey the law they risk losing customers and their reputation, being fined and/or being restricted from trading. SME owners must understand the legal regulations regarding business name registration, land zoning, health regulations and other government Acts like the Competition and Consumer Act 2010.

Exercise 3.12

a) Sample Answer: A situational analysis can be an effective planning tool within the business planning process which analyses a business' internal and external business environment. Often written in a summary table form, a situational analysis gives business owners a breakdown of what the business has full control over (i.e. the internal business environment factors) and what the business must be reactive to (i.e. the external business environment factors).

- b) Sample Answer: Operations is when a business uses its inputs and transforms them into their outputs. Whereas, marketing is the coordination of bringing the buyer and seller together in an effort to satisfy the customer's needs and/or wants.
- c) Sample Answer: Monitoring and evaluation is one of the last steps of the business planning process before taking corrective action. Tony must actively monitor and evaluate his business to maximise business performance. To monitor means to check business performance by comparing actual performance versus planned performance. Whereas, to evaluate means to investigate business performance and the difference between the actual and planned performance and to make judgements based on whether the business has achieved their business goals. Tony could use a range of planning tools to monitor business activities including sales reports, budgets and profit comparisons.
- d) Answers could include the importance of a business plan, management – staffing and teams, trend analysis, identifying and sustaining competitive advantage, avoiding over-extension of finance and other resources, using technology, economic conditions

Sample Answer: Two critical issues in business success and failure is identifying and sustaining competitive advantage and avoiding over-extension of financing and other resources.

A competitive advantage is the edge that one business creates over another business. For a business to remain competitive and therefore successful, business owners must ensure their pricing/cost strategy achieves the lowest production costs. In turn, this will allow the business to reduce the product price and ensure efficiencies of production and maximise profits.

A business owner also needs to be aware of the costs of running their business and avoid financially overextending the business when considering purchasing assets, stock or employing staff. Business planning including budgeting will assist the business owners. As well as using leasing as an effective strategy to control the business's capital outgoings.

