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| **Introduction**  When a sole trader sets up they may have some unstated aims or objectives - for example to survive for the first year. Other businesses may wish to state exactly what they are aiming to do, such as Amazon, the Internet CD and bookseller, who wants to “make history and have fun”.  **An aim** is where the business wants to go in the future, its goals. It is a statement of purpose, e.g. we want to grow the business into Europe.  **Business objectives are the stated, measurable targets of how to achieve business aims.** For instance, we want to achieve sales of €10 million in European markets in 2004.  **A mission statement** sets out the business vision and values that enables employees, managers, customers and even suppliers to understand the underlying basis for the actions of the business.  **Business Objectives**  Objectives give the business a **clearly defined target**. Plans can then be made to achieve these targets. This can motivate the employees. It also enables the business to measure the progress towards to its stated aims.  The most effective business objectives meet the following criteria:  **S – Specific** – objectives are aimed at what the business does, e.g. a hotel might have an objective of filling 60% of its beds a night during October, an objective specific to that business.  **M - Measurable** – the business can put a value to the objective, e.g. €10,000 in sales in the next half year of trading.  **A - Agreed** by all those concerned in trying to achieve the objective.  **R - Realistic** – the objective should be challenging, but it should also be able to be achieved by the resources available.  **T- Time specific** – they have a time limit of when the objective should be achieved, e.g. by the end of the year.  The main objectives that a business might have are:  **Survival** – a short term objective, probably for small business just starting out, or when a new firm enters the market or at a time of crisis.  **Profit maximisation** – try to make the most profit possible – most like to be the aim of the owners and shareholders.  **Profit satisficing** – try to make enough profit to keep the owners comfortable – probably the aim of smaller businesses whose owners do not want to work longer hours.  **Sales growth** – where the business tries to make as many sales as possible. This may be because the managers believe that the survival of the business depends on being large. Large businesses can also benefit from economies of scale.  A business may find that some of their objectives conflict with one and other:  Growth versus profit: for example, achieving higher sales in the short term (e.g. by cutting prices) will reduce short-term profit.  Short-term versus long-term: for example, a business may decide to accept lower cash flows in the short-term whilst it invests heavily in new products or plant and equipment.  Large investors in the Stock Exchange are often accused of looking too much at short-term objectives and company performance rather than investing in a business for the long-term.  **Alternative Aims and Objectives**  Not all businesses seek profit or growth. Some organisations have alternative objectives.  Examples of other objectives:  **Ethical and socially responsible objectives** – organisations like the Co-op or the Body Shop have objectives which are based on their beliefs on how one should treat the environment and people who are less fortunate.  **Public sector corporations** are run to not only generate a profit but provide a service to the public. This service will need to meet the needs of the less well off in society or help improve the ability of the economy to function: e.g. cheap and accessible transport service.  **Public sector organisations** that monitor or control private sector activities have objectives that are to ensure that the business they are monitoring comply with the laws laid down.  **Health care and education establishments** – their objectives are to provide a service – most private schools for instance have charitable status. Their aim is the enhancement of their pupils through education.  **Charities and voluntary organisations** – their aims and objectives are led by the beliefs they stand for.  **Changing Objectives**  A business may change its objectives over time due to the following reasons:  A business may achieve an objective and will need to move onto another one (e.g. survival in the first year may lead to an objective of increasing profit in the second year).  The competitive environment might change, with the launch of new products from competitors.  Technology might change product designs, so sales and production targets might need to change. |

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| **Business organisation** | |
| **Subject: Organisation** | http://www.tutor2u.net/assets/img_tutor2u/icon_pdf1.gif[PDF Version of This Revision Note](http://www.tutor2u.net/business/gcse/downloads/organisation_business_departments.pdf) |
| **Topic: Business departments** | |
| A business is normally organised by its functions, e.g. marketing department, accounts department and so on. This is because being grouped together allows the functions to benefit from specialisation and division of labour. This leads to lower unit costs and a greater efficiency. However it can mean that there is departmental rivalry  Larger businesses might have a number of businesses within the whole company. This would be coordinated by a Head Office, where all the major decisions are made.  Other ways of organising the business could be more appropriate for different types of businesses:  **Product** – the functions are organised around the product – so at a business like ICI, who are the UK’s leading chemical manufacturer, a product manager would have a team of functions who would answer to them, like accounting, marketing and production  **Geographical** – a hierarchy might be split according to different places that the product is sold into – for instance a business may have a Far Eastern division of its business, which would take into account the different cultural and supply differences of the region  **Market** – the organisation is based on market segments – so an airline business like British Airways could concentrate on long haul, short haul, holiday makers, business clients and freight  A business whose decision-making comes from one place only is known as a centralised organisation. Normally Head Office will decide on the major elements of strategy, no matter where the manufacturing plants and sales teams are positioned around the country or globe. This means that there are good opportunities for economies of scale.  Other businesses, especially multinationals (see below) will opt for a more decentralised organisation – where the individual businesses within the whole company group, make decisions for themselves. This means that there is more opportunity to react to the changing marketplace (one of the advantages of a small firm). However there is a possibility that these businesses (who may well be in different parts of the world) might be duplicating research or not bargaining in such as strong position as a bigger overall company.  When a business reaches a certain size then it might split into different departments. These departments will specialise, employing people with expertise in these areas. The main departments in a business might be:   |  |  | | --- | --- | | **Department** | **Role** | | Accounts | Provides a detailed record of the money coming in and going out of the business and prepares accounts as a basis for financial decisions | | Human Resources or Personnel | Deals with all the recruitment, training, health and safety and pay negotiations with unions/workers | | Production | Makes sure that the production plans are met on time and products of the right quality are produced | | Purchasing | Buys all the raw materials and goods required for production | | Sales and marketing | Sales function deals with all aspects of selling to customers; the marketing function carries out marketing research, organises advertising and product promotion |      |  |  | | --- | --- | | **Business organisation** | | | **Subject: Organisation** |  | | **Topic: Starting a business - getting the finance** | | |  | | | The entrepreneur will need to finance to the business. This means they will need to find money to pay for:   * The **purchase of plant & machinery**, office equipment etc * Renting or buying **premises and offices** (e.g. the first 3 months’ rent may need to be paid in advance) * **Essential business services** such as insurance * The **purchase of stocks of raw materials and components** to allow production to start * **The wages and salaries** of the first employees to join the business (who may be needed before any goods or services are actually sold) * To **provide financial cover** whilst the business waits for customers to pay   The main ways in which an entrepreneur can find finance for a new business are:   * Own money * Bank loans * Bank overdraft * Money from friends * Grant assistance from government bodies   These types of finance can be split into INTERNAL and EXTERNAL sources of finance. Internal sources of finance are generated from the business itself (e.g. cash from sales) and external sources of finance from outside the business (e.g. a bank loan).  The business can also split the types of finance into categories relating to length of time the money is needed for  **Short-term**: bank overdraft  **Medium term**: bank loan; lease; hire purchase; government grants  **Long term**: bank loan; mortgage; share issue (for limited companies); debenture  **Business Plan**  A business plan sets out how a business is going to achieve its aims and objectives. It is extremely useful for a new business to use a plan because it can be used to show potential investors how their money is going to be spent.  A business plan will probably contain the following elements:   * Statement of aims and objectives * Description of market the business is selling to * Main competitors (how will they respond to a new competitor?) * Production and sales forecasts * Equipment needed * Distribution plan for how to get product to customers   In the plan, great care should be taken to estimate and forecast how the cash will come into and leave the business in the early weeks and months.  This is because in the early days of setting up a business, finance is hardest to manage. It is uncertain how easy it will be to find customers – and will they buy the product or service at the price that is being asked? The business will be incurring significant “start-up costs” which will eat into the available funds. | | | |
| **Introduction**  The growth of a business is when it expands in size. The size of a business can be measured by the following means:   * **Sales turnover (or sales revenue)** * **Number of employees** * **Share capital** (the number of shares times the price of each share) * **Market share** – the sales of the business of a particular product as a proportion of all sales of that type of product. A 5% market share would mean that 1 in 20 of all products sold are sold by that business. * **Number of outlets** (e.g. shops)   They may mean to grow in size or sometimes it just happens without the business making a conscientious effort to do so. Businesses either grow organically or by acquisition and mergers.  **Organic growth** means the business grows by expanding its sales or their operations and is financed through its own profits.  **Acquisitions and mergers** are when the business joins or buys other businesses, not necessary of the same type.  Businesses may wish to expand for the following reasons:   * Benefit from **economies of scale** – lower unit costs due to an increase in size * A larger **market share** (selling more products than before) means they can charge higher prices and gain more profit * As **means of survival** if they wish to compete with other growing businesses   Some businesses start selling or acquiring businesses that are not in the same market as the markets they are presently selling in. This is known as **diversification**.  Businesses may wish to diversify because:   * Helps **spread the risks across a number of products**. If one product fails due to market conditions then other products in different markets should not be affected. * Good way of **expanding** if present market seems already full. * Gives the business **fresh objectives** and may act to motivate managers and staff.   A business can **grow organically** in the following ways:   * **Lower price -** People will buy more at lower prices. * **Increase advertising -** Customers are made more aware of the attraction of the products. * **Sell in different location -** Selling to a new set of customers, more potential. * **Sell on credit -** Customers are attracted by the ability to buy now pay later.   **Mergers and Acquisitions**  A merger is where two or more businesses **AGREE** to join together to become one larger firm. An acquisition is when one firm **BUYS** another firm.  When a one business buys another it is possible that the acquisition or merger integrates the new product with the existing product. This integration can either be vertical or horizontal integration.  Mergers and acquisitions are an important option for larger businesses that wish to grow rapidly. However, they are a high risk strategy – it is easy to buy the wrong business, at the wrong price for the wrong reasons!  The advantages of mergers and acquisitions are:   * Economies of scale, which reduces unit costs. * Greater market share for horizontal integration, which means the business can often charge higher prices. * Spreads risks if products different. * Reduces competition if a rival is taken over. * Other businesses can bring new skills and specialist departments to the business. * It is easier to raise money if a larger business.   The disadvantages of mergers and acquisitions are:   * Diseconomies of scale if business becomes too large, which leads to higher unit costs. * Clashes of culture between different types of businesses can occur, reducing the effectiveness of the integration. * May need to make some workers redundant, especially at management levels – this may have an effect on motivation. * May be a conflict of objectives between different businesses, meaning decisions are more difficult to make and causing disruption in the running of the business.   **Constraints on Growth**  Though a business may wish to grow in size, there may be reasons why it cannot do this:  **Financial limitations** – a business may not be able to raise the necessary finance to grow any bigger – perhaps it has not made enough profits to generate the cash or the bank is not keen to lend it more money at the moment.  **Size of the market** – there is often a limit to number of people who are willing to buy the type of product that the business is producing – e.g. a printing press manufacturer will know that there are only a small number of publishers in the UK who will be able to buy the product.  **Government controls** means that a business cannot necessarily have more than 25% of the market share. This often arises when one business joins with another. If the government thinks it is not in the public interest to have such a large business, then the joining together may not take place.  **Human resources** are limited in terms of the skills available. Especially in more specialised areas it may be difficult to find enough qualified staff in the area to expand the business. In the South East of England, where unemployment is very low for some types of jobs, businesses have struggled to expand for this very reason. | |

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| **Business organisation** | |
| **Subject: Organisation** |
| **Topic: Franchises** | |
| A franchise is where a business sells a sole proprietor the right to set up a business using their name. Examples of major franchises are:   * McDonalds * Clarks Shoes * Pizza Hut * Holiday Inn   **The franchisor** is the business whose sells the right to another business to operate a franchise – they may run a number of their own businesses, but also may want to let others run the business in other parts of the country.A franchise is bought by the **franchisee** – once they have purchased the franchise they have to pay a proportion of their profits to the franchiser on a regular basis. Depending on the business involved, the franchiser may provide training, management expertise and national marketing campaigns. They may also supply the raw materials and equipment.  The advantages of being a franchisor:   * Large companies see it as a means of rapid expansion with the franchisee providing most of the finance. * If the franchise model works, then there are large profits to made from * - selling franchises * - royalty payments * - selling raw materials and equipment.   The advantages of setting up as a franchisee are:   * The franchisee is given support by the franchiser. This includes marketing and staff training. So starting a business in this way requires less expertise and is less lonely! * The franchisee may benefit from national advertising and being part of a well-known organisation with an established name, format and product * Less investment is required at the start-up stage since the franchise business idea has already been developed * A franchise allows people to start and run their own business with less risk. The chance of failure among new franchises is lower as their product is a proven success and has a secure place in the market   The disadvantages of setting up as a franchisee are:   * Cost to buy franchise – can be very expensive (hundreds of thousands of pounds). * Have to pay a percentage of your revenue to the business you have bought the franchiser from. * Have to follow the franchise model, so less flexible. You would probably be told what prices to set, what advertising to use and what type of staff to employ.   In conclusion, a buying a franchise a good way of an individual setting up a business because:  They do not have to establish themselves in the same as a sole trader might have to.  They will have the support of a tried and tested business model, often with a national marketing campaign behind them. | |

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| A **co-operative** is where a number of individuals or businesses work together to achieve a common purpose. They are normally formed so individuals and small businesses can benefit from being part of a larger group, meaning they have more power to buy or bargain.  There are three main types of co-operatives:   * Retail co-operatives * Marketing or trader co-operatives * Worker co-operatives   A retail co-operative is probably the most familiar co-op. The Co-Op shops and Leo Hypermarkets are a regular sight in the high street.  The objectives of a co-op tend to set them apart from other businesses. The objectives are normally more focused on the members of the co-operative, the local community and the world community. Though profits are required to enable them to reinvest in their business, they will not be a primary objective.  Though co-operatives exist to overcome some of the trading difficulties faced by small businesses, they can still face of number of problems in their operation:   * The system of one member one vote in some societies means a long, drawn out decision-making process * Co-operatives may find it difficult to raise finance since banks are not so willing to lend them money because their main aim is not to make a profit * Idealistic and ethical aims may not be agreeable with all members, so creating unrest and disharmony * The aims held by many co-operatives may not lead to profits in the long run (though many co-op shops will continue to exist at a loss because the owners feel they are providing an important service to the community.) |
| **Business organisation** |
| **Topic: Span of Control and Hierarchies** |
| In a business of more than one person, unless the business has equal partners, then there are managers and subordinates. Subordinates are workers controlled by the manager.  A hierarchy describes the structure of the management of the business, from the top of the company – the managing director, through to the shop floor worker, who reports to their foreman, in a manufacturing business.  The hierarchy of a business is usually best understood by drawing an **organisation chart** showing which levels of management and employees report to whom.  An example of a hierarchy is shown in the diagram below  http://www.tutor2u.net/business/gcse/organisation_public_sector_clip_image002.jpg  **A span of control** is the number of people who report to one manager in a hierarchy. The more people under the control of one manager - the wider the span of control. Less means a narrower span of control.  An example of a narrow span of control is shown in the diagram below:  http://www.tutor2u.net/business/gcse/organisation_public_sector_clip_image003.gif  The advantages of a narrow span of control are:   * A narrow span of control allows a manager to communicate quickly with the employees under them and control them more easily * Feedback of ideas from the workers will be more effective * It requires a higher level of management skill to control a greater number of employees, so there is less management skill required   An example of a wide span of control is shown in the diagram below:  http://www.tutor2u.net/business/gcse/organisation_public_sector_clip_image004.gif  The advantages of wide span of control are:   * There are less layers of management to pass a message through, so the message reaches more employees faster * It costs less money to run a wider span of control because a business does not need to employ as many managers   The width of the span of control depends on:  **The type of product being made** – products which are easy to make or deliver will need less supervision and so can have a wider span of control  **Skills of managers and workers** – a more skilful workforce can operate with a wider span of control because they will need less supervision. A more skilful manager can control a greater number of staff  A tall organisation has a larger number of managers with a narrow span of control whilst a flat organisation has few managers with a wide span of control.  A tall organisation can suffer from having too many managers (a huge expense) and decisions can take a long time to reach the bottom of the hierarchy  BUT, a tall organisation can provide good opportunities for promotion and the manager does not have to spend so much time managing the staff  **Chain of command** is the line on which orders and decisions are passed down from top to bottom of the hierarchy. In a hierarchy the chain of command means that a production manager may be higher up the hierarchy, but will not be able to tell a marketing person what to do.  The advantages of hierarchies are:   * Helps create a clear communication line between the top and bottom of the business – this improves co-ordination and motivation since employees know what is expected of them and when. * Hierarchies create departments and departments form teams. There are motivational advantages of working in teams.   The disadvantages of hierarchies are:   * The formation of departments can mean that: * - Departments work for themselves and not the greater good of the business. * - Departments do not see the whole picture in making decisions. * Hierarchies can be inflexible and difficult to adjust, especially when businesses need to adapt to changing markets – remember employees do not tend to react well to change. |
| **Topic: Introduction to the External Business Environment** |
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| **Introduction**  A business does not function in a vacuum. It has to act and react to what happens outside the factory and office walls. These factors that happen outside the business are known as **external factors or influences**. These will affect the main internal functions of the business and possibly the objectives of the business and its strategies.  **Main Factors**  The main factor that affects most business is the **degree of competition** – how fiercely other businesses compete with the products that another business makes.  The other factors that can affect the business are:   * **Social** – how consumers, households and communities behave and their beliefs. For instance, changes in attitude towards health, or a greater number of pensioners in a population. * **Legal** – the way in which legislation in society affects the business. E.g. changes in employment laws on working hours. * **Economic** – how the economy affects a business in terms of taxation, government spending, general demand, interest rates, exchange rates and European and global economic factors. * **Political** – how changes in government policy might affect the business e.g. a decision to subsidise building new houses in an area could be good for a local brick works. * **Technological** – how the rapid pace of change in production processes and product innovation affect a business. * **Ethical** – what is regarded as morally right or wrong for a business to do. For instance should it trade with countries which have a poor record on human rights.   **Changing External Environment**  Markets are changing all the time. It does depend on the type of product the business produces, however a business needs to react or lose customers.  Some of the main reasons why markets change rapidly:   * Customers develop new needs and wants. * New competitors enter a market. * New technologies mean that new products can be made. * A world or countrywide event happens e.g. Gulf War or foot and mouth disease. * Government introduces new legislation e.g. increases minimum wage.   **Business and Competition**  Though a business does not want competition from other businesses, inevitably most will face a degree of competition.  The amount and type of competition depends on the market the business operates in:   * **Many small rival businesses** – e.g. a shopping mall or city centre arcade – close rivalry. * **A few large rival firms** – e.g. washing powder or Coke and Pepsi. * **A rapidly changing market** – e.g. where the technology is being developed very quickly – the mobile phone market.   A business could react to an increase in competition (e.g. a launch of rival product) in the following ways:   * **Cut prices** (but can reduce profits) * **Improve quality** (but increases costs) * **Spend more on promotion** (e.g. do more advertising, increase brand loyalty; but costs money) * **Cut costs**, e.g. use cheaper materials, make some workers redundant   **Social Environment and Responsibility**  Social change is when the people in the community adjust their attitudes to way they live. Businesses will need to adjust their products to meet these changes, e.g. taking sugar out of children’s drinks, because parents feel their children are having too much sugar in their diets.  The business also needs to be aware of their social responsibilities. These are the way they act towards the different parts of society that they come into contact with.  Legislation covers a number of the areas of responsibility that a business has with its customers, employees and other businesses.  It is also important to consider the effects a business can have on the local community. These are known as the **social benefits** and **social costs.**  **A social benefit** is where a business action leads to benefits above and beyond the direct benefits to the business and/or customer. For example, the building of an attractive new factory provides employment opportunities to the local community.  **A social cost** is where the action has the reverse effect – there are costs imposed on the rest of society, for instance pollution.  These extra benefits and costs are distinguished from the private benefits and costs directly attributable to the business. These extra cost and benefits are known as externalities – external costs and benefits.  Governments encourage social benefits through the use of subsidies and grants (e.g. regional assistance for undeveloped areas). They also discourage social costs with fines, taxes and legislation.  Pressure groups will also discourage social costs. |

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| **External business environment** | | | | | | |
| **Subject: External environment** | | | |  | | |
| **Topic: Economic sectors** | | | | | | |
| Business activity is the process of transforming inputs into outputs by adding value. There are three main sectors of business activity:  **Primary sector** Involves the extraction and production of raw materials, such as coal, wood and steel. A coal miner and a fisherman would be workers in the primary sector.  **Secondary sector** Involves the transformation of raw materials into goods e.g. manufacturing steel into cars. A builder and a dressmaker would be workers in the secondary sector.  **Tertiary sector** Involves the provision of services to consumers and businesses, such as cinema and banking. A shopkeeper and an accountant would be workers in the tertiary sector.  Goods move through a **“chain of production”**. The chain of production follows the construction of a good from its extraction as a raw material through to its final sale to the consumer. So a piece of wood is cut from a felled tree (primary sector), made into a table by a carpenter (secondary) and finally sold in a shop (tertiary).  Some businesses have elements of all sectors in their chain of production. Others businesses choose to specialise. **Specialisation** occurs when a producer concentrates on making a small number of products, or on providing a narrowly defined service.  Examples of specialisation:   * Baker only baking bread * Machinery that only cuts sheet metal * Lawyer dealing only with criminal law   **Advantages of specialisation**  Producer becomes more efficient because they learn the best way (all the short cuts) to produce at the lowest cost  A producer may be able to charge a higher price from a customer – the customer is prepared to pay more for expert/specialist knowledge (e.g. a cosmetic surgeon)  **How Business Activity is Changing**  In the UK the tertiary industry has grown in importance due to:   * Changes in household behaviour * Changes in business behaviour   The main changes in household behaviour are:   * **Higher incomes** - this has meant that households demand more services such as more holidays and eating out in restaurants, because they can afford to do so * **More leisure time** – and so more time to spend on services, such as cinemas. * Businesses offer more **after sale services** e.g. help lines offered through telephone call centres, since customers demand it   In terms of changes in business behaviour:  New and existing businesses need more sophisticated forms of support  **Money and finance** – cash is needed for expansion. Banks and other lenders offer many different ways for businesses to borrow money that best suit their needs. E.g. an overdraft for a short period, a loan for a longer period.  **Telecommunications** – the ability to communicate internally and externally is vital for business success. Speed, cost and flexibility are all factors in determining the use of the type of wiring a business may need. A number of businesses are now using wireless networks.  **Local services** – businesses will need the support of local amenities and shops to service their workers and their day-to-day needs (e.g. food for canteens). | | | | | | |
| **External business environment** | | | | | | |
| **Subject: External environment** | | | | |  | |
| **Topic: Government economic policy** | | | | | | |
| The government’s main economic aims are:  **Economic growth** – more goods and services produced in the economy.  **Low inflation** – prices that are not rising too fast.  **Low unemployment** – as many people employed as possible.  Fair **distribution of income**  The main policies used by government to achieve these aims are:  **Fiscal policy** – government spending and taxation. Government spending is also known as **public expenditure.**  **Monetary policy** – interest rates (the cost of borrowing money and rewards for saving).  **Legislation** – laws that affect the way that a person or business can act.  The UK Government spends over £400bn a year and takes about the same in taxes. It also passes legislation. These affect the way business can act, e.g. what it can produce, how much it costs and who it can employ. It also affects the way that consumers spend their money.  **Taxation**  Taxation comes in two forms:  **Direct taxation** – taxation on income and profits (income tax, National Insurance and corporation tax).  **Indirect taxation** – taxation on spending (VAT, excise duty).  Some examples of UK taxation are shown in the table below:   |  |  |  | | --- | --- | --- | | **Example** | **Type of tax/how it works** | **Effects on business if the tax rises** | | **Income tax** | A percentage of an individual’s income is taken in tax. | A reduction in disposable income (money available to spend after tax); therefore households will not be able to spend as much, reducing sales. | | **VAT** | A percentage (17.5% currently in the UK) is added to the price of the item. It does not apply to all goods, e.g. children’s clothes. | Increases the cost of the product, leading to fewer sales. | | **Tax on beer (excise duty)** | An amount is added to the cost of beer. | Increases the cost of the product, leading to fewer sales. | | **Corporation tax** | A tax on profits made by businesses. | Reduces the amount of profit available at the end of the year to be either distributed to the shareholders or to pay for more investment. | | **National insurance** | A tax on incomes (like income tax).  BUT also a tax on businesses who have to pay a portion of the tax on behalf of the worker | The same as income tax and corporation tax but added to together. |   **Government Spending**  The UK government spends approximately £400bn a year. Over a third of this money goes in welfare benefits such as pensions, unemployment benefit and other forms of income support. The rest is spent on health, education, defence, roads, law and order and on supporting businesses and local communities.  Businesses can benefit direct or indirectly from the rest of the spending.  Governments provide money in the form of grants, subsides and tax breaks (paying less tax than you should) to encourage businesses in certain areas of the economy. A business that is starting out, or is going to provide employment in a depressed area may be able to benefit from such help.  Examples of government assistance are:  **Regional selective assistance** that gives help to businesses wanting to set up in areas of high unemployment.  **Enterprise zones** aim to attract businesses to inner city areas.  Governments also provide support through advisory bodies coordinated by the Department of Trade and Industry, especially for small businesses.  Other bodies also provide information and support such as the Chambers of Commerce. This organisation represents businesses in a local community, acting as a source of advice from the experiences of other businesses and exploiting the connections within these businesses.  Businesses can also benefit indirectly because of the huge spending that governments undertake. For instance the increases in health spending will benefit businesses that produce medical products or services to hospital (e.g. cleaning). | | | | | | |
| **External business environment** | | | | | | |
| **Subject: External environment** |  | | | | | |
| **Topic: Economy - Exchange Rates** | | | | | | |
| An exchange rate is the value of one currency expressed in terms of another. So £1 may be worth $1.55 and €1.33.   * A currency that is getting **stronger or appreciating** is a currency that is going up in value against another. So £1:$1.5 moving to £1:$1.8 means the pound is getting stronger * A currency that is becoming **weaker or depreciating** is a currency that is going down in value against another. So £1:$1.8 moving to £1:$1.5 means the pound is getting weaker   Currencies change in value against each other all the time. This is because most currencies are based on flexible exchange rates. The notable difference is in the Euro zone (see below).  Currencies change in value because there is a change in demand for holding that currency. Households, governments and businesses need other countries currencies to buy their goods and services (e.g. holiday makers for purchasing wine or a business buying spare parts for machinery from France will need Euros).  A change in exchange rates might affect a business in the following ways:   * Exchange rates changes can increase or lower the price of a product sold abroad * The price of imported raw materials may change * The price of competitors’ products may change in the home market   For example an increase in the exchange rate will mean that price abroad goes up, lowering sales; price of imported raw materials falls, either leading to a fall in price and more sales, or an increase in profits; competitors’ prices fall, meaning lower sales.   |  |  |  |  | | --- | --- | --- | --- | | **Exchange rate** | **French car (€15,000)** | **UK car (£12,000)** | **French raw materials (€4 per kilo)** | | *Originally £1:€1.5* | *£10,000 in the UK* | *€18,000 in France* | *£2.67 to UK businesses* | | £ appreciates £1:€1.8 | £8,333 | €21,600 | £2.22 | | £ depreciates £1:€1.2 | £12,500 | €14,400 | £3.33 | | | | | | | |
| **External business environment** | | | | | | |
| **Subject: External environment** | |  | | | | |
| **Topic: Economy - interest rates** | | | | | | |
| Interest rates are the **“cost of money”**. If you borrow money then you may have to pay back the original amount PLUS a charge for borrowing the money. That charge is known as interest. It is a percentage of the original amount. You may have to pay the interest weekly, monthly or annually. It is also the reward for saving – you receive a percentage of the original amount.  There is never just one interest rate. There are many rates based on whether you are a borrower or saver, the type of borrowing you are making and your personal or business circumstances. However the rates will tend to move up and down with the BASE RATE, which is a central rate, set by the **Monetary Policy Committee** of the **Bank of England**.  The following types of borrowing and saving often have an interest rate attached:   * Bank loans * Mortgages (borrowing to purchase a property) * Debentures * Deposit accounts * Bank current accounts * Credit cards   A change in interest rates affects businesses in the following ways:   * If the business has loans then an increase in interest rates will mean higher repayments, reducing profits. * If the business wants to borrow money to say build new premises, then they are less likely to go ahead with the project when interest rates increase. * Customers are going to find that they are more attracted to saving than to spending if interest rates go up and less likely to borrow money to spend as well. This may reduce sales for the business. | | | | | | |
| **External business environment** | | | | | |
| **Subject: External environment** | | |  | | |
| **Topic: Economy - labour and unemployment** | | | | | |
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| The **labour market** is where businesses hire workers. A business needs people to help the day to day running of the operation. The amount of labour needed depends on whether the business is a labour intensive or capital intensive.  A business that needs more people and less machinery is known a **labour-intensive** business. Hairdressing, house building, teaching and the fashion industry are examples of labour intensive industries.  A **capital-intensive** industry is where a business relies heavily on **machinery and technology** in its transformation of inputs into outputs. Good examples include the car industry, steel production and the rail industry.  **Unemployment** is where there are people you are willing and able to work but cannot find employment at the going wage rate. For example a machine worker who cannot get a job because there are no jobs for machine workers in the area. High unemployment, though it can be bad for local sales, can provide a business with a good source of cheap labour.  On the other hand a shortage of labour might cause difficulties for a business:   * It may be more difficult to recruit new people - which might prevent the business from growing as fast as it wishes * Existing workers may demand higher wages because they know that the business will be reluctant to release them. * Competitors may try harder to poach the best staff. * The business may have to invest further in staff training and development rather than rely on “recruiting” new skills into the business.   Recruitment of personnel can also depend on the mobility of labour in the labour market.  **Mobility of labour** means the speed with which a person can move into a different job. There are two main types:  **Geographical mobility**  Can they physically move to that place of work? This depends on the transport links as well as people’s desire to move house to get a job.  **Occupational mobility**  Do they have the skills to do the new job? This depends on the education and training that people have. Even with GCSEs and A levels students will need more training to do many jobs.  The state of the regional labour market will be a major influence on location decisions for businesses. In the South East, especially near London, there is low unemployment, so it will be difficult to find cheap labour, though there is good pool of skilled labour. This is because a business may be able to attract good workers from other businesses, at higher wages though. In the North East there are pockets of high unemployment, with skilled workers without jobs, because some of the more traditional industries have declined. | | | | | |

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| **Introduction**  **Financial accounts** are the records of the financial dealings of the business, their every day transactions.  The main role of financial accounting is to:  **Record financial transactions;** e.g. collecting money from sales, paying suppliers, salaries and wages.  **Help the managers to manage the business** more efficiently by preparing regular financial information e.g. monthly management accounts showing sales, costs and profits against budgets, forecasting cash flows, cost investigations.  **Provide other stakeholders with legal/vital information** (financial accounts: trading account, profit and loss, and balance sheet).   * Shareholders – how their investment is doing. * Suppliers – can they give the business trade credit. * Banks and lenders – can the business meet repayments of loans and risks of loaning the business money. * Inland revenue – tax returns.   The main accounting records kept by the business are records for keeping the details of transactions:  **Sales ledger:** shows how much is owed by customers who have bought on credit.  **Purchase ledger:** shows how much is owed by the business to suppliers who have provided goods and services on credit.  **Cash book and bank statements:** shows all transactions involving cash (e.g. receipts from customers, payments to suppliers, employee wages).  **Nominal (or “General”) ledger:** used to categorise the transactions of a business under headings e.g. sales of widgets, raw materials, electricity, and postage.  These records are used to maintain the information that is used to make up the main financial statements.  **Financial Statements**  Financial accounting produces the following key documents:  **Profit and loss account** – showing how the business has traded for a specific period.  **Balance sheet** – a statement of the assets and liabilities of a business at a particular time, and how those assets and liabilities have been financed.  **Cash flow statement** – a statement showing how cash has come into the business and what it has been spent on. |

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| **Finance and accounts** | | | | |
| **Subject: Accounts** | | |  | |
| **Topic: What is profit?** | | | | |
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| Profit is the difference between the income of the business and all its costs/expenses. It is normally measured over a period of time.  They are four main types of profit quoted by a business:  **Gross profit**  This is the difference between sales income and the direct costs of making those products. Gross profit is used as a performance indicator to help the business make decisions over its pricing policies and use of materials.  **Net profit**  Net profit represents gross profit less all expenses associated with the normal running of the business. Net profit shows how well the business performs under its normal trading circumstances. It is used to calculate the “primary efficiency” ratio.  **Net profit after interest and taxation**  This is the profit available for the shareholders. Net profit after interest and taxation is all due to the owners of the business. They can choose to take out, in the form of dividends, all, some or none of this.  **Retained profit**  Retained profit is the profit left over after the shareholders have been paid their dividends. Retained profit is normally reinvested in the business.  Profit is important to a business because:  **It is a reward to the owners of the business.** They have taken risks with their money and time. If there was no profit, then there would be little point in starting up or putting more money into the business, they might as well put the money into a bank or building society  **Profits are an important source of investment funds.** Profit can be used to buy more stock, improve technology or expand the premises  A business than does not make a profit will fail, potentially affecting employees, suppliers and the local community  Many businesses do not face a dilemma or problem over the amount of profit they make, because they are just happy to make a profit in the first place.  However there are situations where businesses can exploit the customers because there is not much competition from other businesses. A business will need to an ethical view (what is morally right) on how much to charge and whether they believe their profits to be excessive.  It needs to be remembered that profits are used to reinvest, which leads to better products for their customers, better wages and working conditions for their workers or to help the local community. | | | | |
| **Finance and accounts** | | | | |
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| **Topic: Business Costs** | | | | |
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| **Introduction**  A business has many different costs, from paying for raw materials through to paying the rent or the heating bill. By careful classification of these costs a business can analyse its performance and make better-informed decisions.  The main ways in which a business needs to manage its costs are as follows:  **Classification of costs** into fixed and variable, direct and indirect.  **Variance analysis** to see if the business is keeping control of its costs.  **Break even analysis** which tells a business what it needs to sell to cover its costs.  **An opportunity cost** is the financial benefit forgone of the next best alternative use of money. A business can measure the outcome of a decision by comparing it with the benefits (probably measured in profits or revenue) it could have had if it had taken the next best option. The opportunity cost of buying a new piece of machinery might be compared with the benefits of spending the money on a new advertising campaign.  **Fixed and Variable Costs**  **Variable costs** change in proportion to the amount of output produced.  **Fixed costs** remain the same, no matter how much the business produces.  The main kinds of costs are:   |  |  | | --- | --- | | **Variable costs** | **Fixed costs** | | Raw materials | Rent | | Workers wages | Salaries of head office workers | | Energy/fuel for machines | Heating and lighting | |  | Insurance | |  | Interest on loans |   **Semi-fixed costs** are costs which only change when there is a **large change in output**. For example, costs associated with buying a new machine to cope with increased production.  Also telephones and electricity for instance have a fixed and variable element: a standard line rental and then a charge for each call/unit of electricity after that.  **Direct costs** are costs which can be identified directly with the production of a good or service; e.g. raw materials.  **Indirect costs** are costs which cannot be matched against each product because they need to be paid whether or not the production of good or services takes place; e.g. rent on the premises.  Classification of costs help allocate costs to right parts of the profit and loss account and also helps analysis of the break even point of the business. | | | | |
| **Breakeven**  A business can work out how what volume of sales it needs to achieve to cover its costs. This is known as the **break even point.**  The key to break even is to work out the contribution made from the sale of each unit.  The amount of money each unit sold **contributes** to pay for the fixed and indirect costs of the business.  **Contribution = selling price less variable cost per unit**  E.g. a product sells for £15 and has variable costs per unit of £11. Each unit sale therefore makes a contribution of £4 towards the fixed costs of the business. If the business had fixed costs of £20,000, then it would need to sell 5,000 units (£4 x 5,000 = £20,000 contribution) in order to break even.  The margin of safety is the difference between the number of units of planned or actual sales and the number of units of sales at break even point.  If, using the example above, planned sales were thought to be 6,000 units, then the margin of safety would be 6,000 units – break even 5,000 units = 1,000 units. The business would be able to sell 1,000 less than planned before they were in danger of making a loss.  A break-even chart plots the sales revenue, different costs and helps identify the break even point and margin of safety.  **rawing break-even charts**  To draw a chart the following steps need to be followed:  1. Label the vertical axis “sales and costs in pounds”.  2. Label the horizontal axis “sales/production (units)”.  3. On another piece of paper sketch the scales that you want to use given the data, then use this plan on the chart.  4. Plot any two points from the sales revenue data for the sales revenue line and then draw a straight line for sales revenue (assumes that the price per unit does not change) – if the information is not given for sales revenue, then work out two points, e.g. for 1000 units sold and 1500 units sold. The start of the line should be through the origin (where the axes meet).  5. Draw a horizontal line for total fixed costs starting at the point on the vertical axis at the level of costs.  6. At the same starting point it is possible to draw the total costs line. Total costs are fixed costs plus variable costs. Work out what the total costs are for say 1000 units and 1500 units. Then draw the straight line starting at the same point as the fixed costs started and then through the two plotted points.  7. Where the sales revenue crosses the total costs line is the break even point. Read off the units of sales to give the break even level of sales.  8. The gap between the total costs line and sales revenue line after the break even point represents the level of profit.  http://www.tutor2u.net/business/gcse/finance_business_costs_clip_image001.jpg  It is important for a business to understand its break-even point because the contribution from every unit sold above the break-even point adds to profit. The break-even point provides a focus for the business, but also helps it work out whether the forecast sales will be enough to produce a profit and whether further investment in the product is worthwhile.  The main limitations of break-even charts are:   * Do not take into account possible changes in costs over the time period. * Do not allow for changes in the selling price. * Analysis only as good as the quality of information. * Do not allow for changes in market conditions in the time period – e.g. entry of new competitor. | | | | |
| **Profit and Loss Account**  The purpose of the profit and loss account is to:   * Show whether a business has made a **PROFIT** or **LOSS** over a financial year. * Describe how the profit or loss arose – e.g. categorising costs between **“cost of sales”** and **operating costs.**   A profit and loss account starts with the **TRADING ACCOUNT** and then takes into account all the other expenses associated with the business.  **Trading account**  The trading account shows the income from sales and the direct costs of making those sales. It includes the balance of stocks at the start and end of the year.  An example of the trading account of a business would look this:  Trading account for XYZ plc for the year ended 31 st March 2003   |  |  |  | | --- | --- | --- | | Category | £ | £ | | Sales |  | 1,200,000 | | Opening Stock | 150,000 |  | | Purchases | 400,000 |  | | less Closing Stock | (220,000) |  | | Cost of Sales | 330,000 | (330,000) | | Other Costs |  | (70,000) | | Gross Profit |  | 800,000 |   Note that the closing stock figure would appear in the balance sheet under Stock.  **Profit and loss account**  The trading account now has all the other expenses now deducted.  It would look like the table below:  **Trading, profit and loss account for XYZ plc for the year ended 31 st March 2003**   |  |  |  |  | | --- | --- | --- | --- | |  | **£’000** |  | **Examples** | | Turnover (sales) revenue | 1,200 | The amount of money  generated by sales | e.g. 400 cars at £3,000 each | | Cost of sales | (400) | The cost of making the  goods or buying them | Raw materials  Cost of labour working directly on each  product  Cost of running the machines/equipment | | Gross profit | 800 | Turnover minus cost of sales |  | | Overheads or  expenses | (320) | Costs not directly involved in the production process  (indirect costs) | Cost of premises e.g. rent, insurance, repairs  Office costs e.g. stationery, postage, computer maintenance, staff salaries and wages  Sales and marketing costs e.g. salaries of salesmen, advertising  Finance costs e.g. bank charges, interest on bank loans | | Operating profit | 480 | Gross profit minus overheads Also known as NET PROFIT |  | | Interest and taxation payable | (200) | The money that is due to be paid in interest on loans and to the Inland  Revenue as tax | | | Net profit after tax and interest | 280 | The money available to be distributed to shareholders | | | Dividends | (170) | Money paid to shareholders as a reward for holding shares | | | Retained profit | 90 | The money left for the business to reinvest | |   The business has to pay tax at the rate determined by the government and interest at the rates determined by the lenders. | | | | |
| **Finance and accounts** | | | | |
| **Subject: Accounts** |  | | | |
| **Topic: Bank loans and overdrafts** | | | | |
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| **Bank Loans and Overdrafts**  A **bank overdraft** is a limit on borrowing on a bank current account. With an overdraft the amount of borrowing may vary on a daily basis.  A **bank loan** is a fixed amount for a fixed term with regular fixed repayments. The interest on a loan tends to be lower than an overdraft.  Example of a loan:  A business borrows £12,000 from a bank over 3 years at an interest rate of 5%. The approximate repayments on this loan would be £392 a month for 36 months (£14,112).  A fixed term means how many months or years before the loan has to be repaid in full.  Normally a fixed term loan will be for a greater amount than an overdraft.   |  |  |  | | --- | --- | --- | |  | **Overdrafts** | **Loans** | | **Advantages** | Flexibility – can change the amount borrowed within limits  Interest is only paid on amounts borrowed | Larger amounts can be borrowed  Lower interest rates than overdrafts  Regular repayments help plan cash flow | | **Disadvantages** | Cannot be used for large borrowing  Rates of interest higher than loans  Bank can change limit at any time or ask for money to be paid back sooner than expected | Less flexible than an overdraft  Have to pay back in stated time or risk further financial problems |   **Debentures**  A debenture is a **long term loan** which is usually **secured** against a specific asset (e.g. the factory) or the overall assets of a business. A debenture is **repayable** at a fixed date and has a **fixed rate of interest.**  Debentures are different from ordinary shares because:  The lender has no voting rights in the company.  The loan attracts interests – whereas holders of ordinary shares get dividends.  The providers of loans are paid out before ordinary shareholders in the event that the business fails (assuming there is some cash left). | | | | |
| **Equity finance**  Equity finance is the money provided by the owners of the business.  **SOLE TRADERS AND PARTNERSHIPS**  A sole trader will provide money from his or her own savings.  A sole trader may find it difficult to raise much money from this source and therefore may take on a partner who brings money into the business.  **LIMITED COMPANIES**  A limited company can sell shares, which represent how much of the business the shareholder owns.  There are two types of limited company that define the way that money can be raised through shares.  A **private limited company** can sell shares only to designated people and there is a limit how much capital they can raise through this method.  A **public limited company** can issue shares to the public. This means anyone can have a share in the company.  It is important to note that once a share is issued, it only raises money for the company the first time it is sold. After that the proceeds any sale of that share goes to the owner of the share. It is like a second hand car. When a BMW is sold second hand, then the money goes to the owner of the car and not BMW.  A company may wish to issue shares because:   * A large amount of money can be raised through a share issue. * Unlike a loan the money does not have to be repaid over a fixed period of time.   A company may issue two types of shares:  **Ordinary shares**   * Ordinary shareholders can vote at company meeting. * The amount of the dividend received varies.   **Preference shares**   * Preference shareholders do not have a vote at company meetings. * The dividend is usually fixed (e.g. 5% of the value of shares held paid as dividend each year). * Preference shareholders receive their dividend before ordinary shareholders.   Shares are bought because they provide a return to the shareholder. There are two parts to the returns earned by shareholders:  **Dividends** paid out on each share held by the company (e.g. companies on the Stock Exchange usually pay out two dividends each year).  **Increases in the value of each share** as the company itself grows in value (this is often known as a “capital gain”).  **In conclusion:**  A business will issue shares to raise large sums of money. By doing this they are “diluting” the ownership which means that the control of the business is spread amongst more people. However they only have to pay dividends and don’t have to pay out dividends at all, especially if they make a loss. But a shareholder has the right to vote off a board of directors, if they can gain 50.1% of support of the rest of the shareholders. | | | | |
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| **Finance and accounts** | | | | |
| **Subject: Accounts** | |  | | |
| **Topic: Other sources of external finance** | | | | |
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| **Leasing**  Leasing is like renting a piece of equipment or machinery. The business pays a regular amount for a period of time, but the item belongs to the leasing company.  Most company cars are leased to businesses. The business pays a monthly fee for the car and at the end of the period (normally about two years), the business swaps the car for a newer model.  The advantages of leasing are:   * Cheaper in the short run than buying a piece of equipment outright. * If technology is changing quickly or equipment wears out quickly it can be regularly updated or replaced. * Cash flow management easier because of regular payments.   The disadvantages of leasing are:   * More expensive in the long run, because the leasing company charges fees which make the total cost greater than the original cost.   **Hire Purchase**  Business hires the equipment for a period of time making fixed regular payments. Once payments have finished it then owns the piece of equipment. Hire purchase is different to leasing in that the business owns the equipment when it has finished making payments. With an equipment lease, the equipment is handed back to the leasing provider.  **Debt Factoring**  A business sells its outstanding customer accounts (those who have not paid their debts to the business) to a debt factoring company.  The factoring company pays the business - say 80-90% of face value of the debts - and then collects the full amount of the debts. Once it has done this it will pay the remaining amount to the business less a charge.  It is a good way of raising cash quickly, without the hassle of chasing payments. BUT it is not so good for profits since it reduces the total revenue received from those sales.    **Government Finance**  The government and the European Union provide help to businesses for the following reasons:   * Protect jobs in failing/declining industries. * Help create jobs in areas of high unemployment. * Help start up new businesses. * Help businesses relocate to areas of high unemployment.   Some of the main sources of funds are:   * European Structural Fund * Assisted Areas * Regional Selective Assistance * Small Loans Guarantee Scheme   **Trade Credit**  A business does not always have to pay their bills as soon as they receive them. They are given period of credit, normally around 30-60 days. By trying to extend this period they can improve their short-term finance position.  Small businesses now have some protection under law that prevents larger firms exploiting their credit terms.  Trade credit is an important source of finance for nearly all businesses – since it is effectively a free source of finance.  **Retained Profits**  The cheapest form of finance is the business’ own profits. In the UK over 80% of retained profits are reinvested back into the business. Since it is not being borrowed from anyone, it does not cost money to use.  **Own Capital**  For sole traders and partnerships a common source of finance, especially for start up is money from the individuals who are forming the business. They may also borrow money from family and friends. Own capital is a costless form of finance, but carries the risk of the money being lost.  **Working Capital**  Working capital is the amount of money available for the day to day running of the business. It is the difference between current assets and current liabilities. See below for more details of how working capital can be used.  **Sources of Finance for Public Sector Organisations**  Public sector organisations receive from both the normal sources that most businesses receive money, but also from tax revenues. Most public sector organisations, such as schools and hospitals obtain more straight from the government - who have previously collected the money from tax payers.  Other organisations gain money from sales, e.g. stamps for the Post Office, and licences for the BBC. | | | | |
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| **Economies of scale** arise when the **cost per unit falls as output increases**. Economies of scale are the main advantage of increasing the scale of production and becoming ‘big’.  Why are economies of scale important?  - Firstly, because a large business can pass on lower costs to customers through lower prices and increase its share of a market. This poses a threat to smaller businesses that can be “undercut” by the competition  - Secondly, a business could choose to maintain its current price for its product and accept higher profit margins. For example, a furniture-maker which could produce 1,000 cabinets at £250 each might expand and be able to produce 2,000 cabinets at £200 each. The total production cost will have risen to £400,000 from £250,000, but the cost per unit has fallen from £250 to £200. Assuming the business sells the cabinets for £350 each, the profit margin per cabinet rises from £100 to £150.  There are two main types of economies of scale: **internal** and **external**. Internal economies of scale have a greater potential impact on the costs and profitability of a business.  **Internal economies of scale**  Internal economies of scale relate to the lower unit costs a single firm can obtain by growing in size itself. There are five main types of internal economies of scale.  **Bulk-buying economies**  As businesses grow they **need** to order larger quantities of production inputs. For example, they will order more raw materials. As the order value increases, a business obtains more bargaining power with suppliers. It may be able to obtain discounts and lower prices for the raw materials.  **Technical economies**  Businesses with large-scale production can use more advanced machinery (or use existing machinery more efficiently). This may include using mass production techniques, which are a more efficient form of production. A larger firm can also afford to invest more in research and development.  **Financial economies**  Many small businesses find it hard to obtain finance and when they do obtain it, the cost of the finance is often quite high. This is because small businesses are perceived as being riskier than larger businesses that have developed a good track record. Larger firms therefore find it easier to find potential lenders and to raise money at lower interest rates.  **Marketing economies**  Every part of marketing has a cost – particularly promotional methods such as advertising and running a sales force. Many of these marketing costs are fixed costs and so as a business gets larger, it is able to spread the cost of marketing over a wider range of products and sales – cutting the average marketing cost per unit.  **Managerial economies**  As a firm grows, there is greater potential for managers to specialise in particular tasks (e.g. marketing, human resource management, finance). Specialist managers are likely to be more efficient as they possess a high level of expertise, experience and qualifications compared to one person in a smaller firm trying to perform all of these roles.  **External economies of scale**  External economies of scale occur when a firm benefits from **lower unit costs as a result of the whole industry growing in size**. The main types are:  **Transport and communication links improve**  As an industry establishes itself and grows in a particular region, it is likely that the government will provide better transport and communication links to improve accessibility to the region. This will lower transport costs for firms in the area as journey times are reduced and also attract more potential customers. For example, an area of Scotland known as Silicon Glen has attracted many high-tech firms and as a result improved air and road links have been built in the region.  **Training and education becomes more focused on the industry**  Universities and colleges will offer more courses suitable for a career in the industry which has become dominant in a region or nationally. For example, there are many more IT courses at being offered at colleges as the whole IT industry in the UK has developed recently. This means firms can benefit from having a larger pool of appropriately skilled workers to recruit from.  **Other industries grow to support this industry**  A network of suppliers or support industries may grow in size and/or locate close to the main industry. This means a firm has a greater chance of finding a high quality yet affordable supplier close to their site. | | | | |
| Increasing the size of a business does not always result in lower costs per unit. Sometimes a business can get too big!  **Diseconomies of scale** occur when a business grows so large that the costs per unit increase.  Diseconomies of scale occur for several reasons, but all as a result of the difficulties of managing a larger workforce.  **Poor communication**  As the business expands communicating between different departments and along the **chain of command** becomes more difficult. There are more layers in the hierarchy that can distort a message and wider **spans of control** for managers. This may result in workers having less clear instructions from management about what they are supposed to do when.  In addition, there may be more written forms of communication (e.g. newsletters, notice boards, e-mails) and less face-to-face meetings, which can result in less feedback and therefore less effective communication.  **Lack of motivation**  Workers can often feel more isolated and less appreciated in a larger business and so their loyalty and motivation may diminish. It is harder for managers to stay in day-to-day contact with workers and build up a good team environment and sense of belonging. This can lead to lower employee motivation with damaging consequences for output and quality. The main result of poor employee motivation is falling productivity levels and an increase in average labour costs per unit.  What can a business do about this? Possible solutions include:  Delegation of decision-making (**empowerment**)  Making jobs more interesting (**job enrichment**)  Splitting employees into teams (**teamworking**)  There is also a close link between communication and motivation (which the motivational theorist Elton Mayo recognized) and so as communication becomes harder, motivation will decline. This is particularly true as managers are less able to take a personal interest in the workers.  **Loss of direction and co-ordination**  It is harder to ensure that all workers are working for the same overall goal as the business grows. It is more difficult for managers to supervise their subordinates and check that everyone is working together effectively, as the spans of control have widened. A manager may be forced to delegate more tasks, which while often motivating for his subordinates, leaves the manager less in control. | | | | |

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| **Topic: Productivity & efficiency** | |
| Flow production involves a continuous movement of items through the production process. This means that when one task is finished the next task must start immediately. Therefore, the time taken on each task must be the same.  Flow production (often known as **mass production**) involves the use of production lines such as in a car manufacturer where doors, engines, bonnets and wheels are added to a chassis as it moves along the assembly line. It is appropriate when firms are looking to produce a high volume of similar items. Some of the big brand names that have consistently high demand are most suitable for this type of production:   * Heinz baked beans * Kellogg’s corn flakes * Mars bars * Ford cars   **Advantages**  Flow production is capital intensive. This means it uses a high proportion of machinery in relation to workers, as is the case on an assembly line. The advantage of this is that a high number of products can roll off assembly lines at very low cost. This is because production can continue at night and over weekends and also firms can benefit from economies of scale, which should lower the cost per unit of production.  **Disadvantages**  The main disadvantage is that with so much machinery it is very difficult to alter the production process. This makes production inflexible and means that all products have to be very similar or standardised and cannot be tailored to individual tastes. However some “variety” can be achieved by applying different finishes, decorations etc at the end of the production line. | |
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| **Topic: Job production method** | |
| Job production involves firms producing items that meet the specific requirements of the customer. Often these are one-off, unique items such as those made by an architect or wedding dressmaker. For an architect, each building or structure that he designs will be different and tailored to the needs of each individual client.  With job production, a single worker or group of workers handles the complete task. Jobs can be on a small-scale involving little or no technology. However, jobs can also be complex requiring lots of technology.  With low technology jobs**,** production is simple and it is relatively easy to get hold of the skills and equipment required. Good examples of the job method include:   * Hairdressers * Tailoring * Painting and decorating * Plumbing and heating repairs in the home   High technology jobs are much more complex and difficult. These jobs need to be very well project-managed and require highly qualified and skilled workers. Examples of high technology / complex jobs include:   * Film production * Large construction projects (e.g. the Millennium Dome) * Installing new transport systems (e.g. trams in Sheffield and Manchester)   **Advantages**  The advantage of job production is that each item can be altered for the specific customer and this provides genuine marketing benefits. A business is likely to be able to ‘add value’ to the products and possibly create a unique selling point (USP), both of which should enable it to sell at high prices.  **Disadvantages**  Whether it is based on low or high technology, Job production is an expensive process as it is labour intensive (uses more workers compared to machines). This raises costs to firms as the payment of wages and salaries is more expensive than the costs of running machines. | |
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| **Production** | |
| **Subject: Production** |  |
| **Topic: Lean production** | |
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| There is much evidence to suggest that the traditional mass production methods, used widely for much of 20 th century, can create problems, which leads to inefficiency. The main problems are:   * **Employee boredom and low morale** – particularly where employees undertake repetitive jobs * **Equipment failure** – regular breakdowns of equipment that can cause hold-ups elsewhere in the production process * **Equipment obsolescence** – where a machine quickly becomes outdated, although there is little incentive to replace it if the machine had cost a lot of money   As a result of these problems, businesses have increasingly looked to see if they can make their production more efficient by becoming more **“flexible”** and **“lean”.**  **Lean production** is an approach which originated in Japan during the 1950’s and 1960’s and has recently been increasing in popularity among UK firms. Its main objective is to **eliminate all forms of waste in the production process** and so **produce more by using fewer inputs**. There are several forms of waste that lean production aims to eliminate.   * Waste from materials * Waste of worker’s time and effort * Waste of floor space * Waste from defective products (poor quality)   By reducing this waste the costs of firms will decrease and they will become more efficient and competitive. The idea is to make the product right first time (not spend time checking and re-checking).  There are several popular **management techniques** that have been developed to help achieve “lean production”. The three most popular are:   * Cell production * Kaizen (continuous improvement) * Just-in-time (“JIT”) manufacturing | |
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| **Cell production**  In traditional production, products were manufactured in separate areas (each with a responsibility for a different part of the manufacturing process) and many workers would work on their own, as on a production line. In **cell production**, workers are organised into **multi-skilled teams.** Each team is responsible for a particular part of the production process including quality control and health and safety. Each cell is made up of several teams who deliver finished items on to the next cell in the production process.  Cell production can lead to efficiency improvements due to increased motivation (team spirit and added responsibility given to cells) and workers sharing their skills and expertise.  **Kaizen**  Kaizen is a Japanese word for an **approach to work** where workers are told they have two jobs to do:  Firstly to carry out their existing task; and  Secondly to come up with ways of improving the task  The concept known as **“continuous improvement”** therefore implies a process where the overall progress and gains in productivity within a firm, come from small improvements by workers being made all the time.  For example, an employee may simply re-organise the lay out of his work area, which saves 2 minutes looking for and filing paperwork each day. When added up the course of a week, 10 minutes extra productive time is gained, which over a year equates to an extra days work. If other workers also adopt this, then a firm can benefit from a significant increase in output per worker (productivity) over a year.  **Just in time**  JIT means that stock arrives on the production line just as it is needed. This minimises the amount of stock that has to be stored (reducing storage costs).  JIT has many benefits and may appear an obvious way to organizes production but it is a complicated process which requires efficient handling. For example, JIT relies on sophisticated computer systems to ensure that the quantities of stock ordered and delivered are correct. This process needs to be carried out very accurately or production could come to a standstill.   |  |  | | --- | --- | | **Advantages of JIT** | **Disadvantages of JIT** | | Reduces costs of holding stock e.g. warehousing rent | Needs suppliers and employees to be reliable | | No money tied up in stock, can be use better elsewhere | May find it difficult to meet sudden increase in demand | |
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| **Production** | |
| **Subject: Production** |  |
| What do we mean by the “quality” of a product or service? A simple definition is:  **“A quality product needs to be ‘fit for purpose’.This means the product must meet or exceed the customer requirements.”**  It should be noted that a good quality product does not therefore have to be an expensive product; it merely has to fulfill its purpose within the eyes of the customer.  For example, a cheap biro or cheap pair of trainers can be good quality as long as they do at least what the customer expects them to do.  It is important to remember that it is the customer who sets the “quality standards” in terms of their overall expectations of quality. There are several ways that a customer may define quality:   * Reliability * Fit for purpose * Design * Safety * Long-lasting   In some cases, government act to encourage minimum standards for certain products. For example, the British Standards Institute in the UK operates a well-known “Kitemark” scheme.  The Kitemark is a certification mark that offers proof that a product or service complies with the relevant publicly available specification. It symbolises quality and safety and is recognized by over 80% of the UK population.  Quality is important for two main reasons: reputation and costs.  **Reputation**  For virtually all purchasing decisions, customers choose which product to buy based on price and/or quality, and occasionally on other factors such as the delivery time. The reputation of a business therefore depends on these factors and it is often quality which can have the longest lasting impression (think of the long-standing jokes about the quality of the old Skoda cars).  Customers often complain about the poor quality of the products and services they buy. Conversely, a positive recommendation by a customer (for example by recommending a product or service to a friend) helps to develop a positive reputation for quality.  There are many situations in which quality can prove to be less than expected: for example:   * Poor service at a restaurant * A flight that runs late or is cancelled * A washing machine that breaks down * Clothing that unexpectedly shrinks in the wash   A good quality product can therefore provide a competitive edge over rivals and can lead to significant marketing advantages. For example, a business will benefit from more repeat purchases and a longer life cycle for its product. It may also be able to charge a premium (higher) price and so boost revenue.  **Costs**  A poor quality product does not only harm reputation and therefore sales but also increases costs to businesses. There are many costs of poor quality, including:   * Cost of reworking or remaking the product * Costs of replacements or refunds * Wasted materials * Costs of employing more staff to detect and solve quality problems   These extra costs will decrease the competitiveness of a business, as it may have to raise prices to cover them. | |

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| **Production** | |
| **Subject: Production** |  |
| **Quality Control**  The objective of quality control is to ensure each finished product meets the standard set out by the business for a quality product. The traditional method by which a firm tries to achieve this quality standard is by having a separate Quality Control department whose inspectors check the finished items and reject defective or substandard products.  This method therefore **detects** quality problems at the end of the production process before they reach the final customer. The Quality Control department would then try and change an aspect of the production process and procedure, in order to solve quality problems that seem to occur most often.  This approach hopefully stops defective products getting to the market place and harming a firm’s reputation but evidence shows that it has limited success at reducing the number of sub standard products being produced and therefore wasting a firm’s resources.  **Total Quality Management**  An alternative and increasingly popular method of ensuring quality is known as **“Total Quality Management”** or **“TQM”**. TQM is best described as being an “attitude” in a business where everyone in the business is committed to achieving quality – not just the people in the Quality Control or production departments. It means that quality is being checked at every stage of the production process, as all employees are trained to check their own work (self-checking).  Two of the main aims of TQM are **“zero defects”** and **“total customer satisfaction**”. “Zero defects” refers to the aim of producing goods and services with no faults or problems.  To achieve this requires:   * Strong teamwork * Open sharing of information about what quality problems are arising and how they are caused * Investment in improving and refining production processes   There are various advantages and disadvantages of introducing TQM:   |  |  | | --- | --- | | **Advantages** | **Disadvantages** | | Improves reputation- faults and problems are spotted and sorted quicker (zero defects) | Initial introduction costs- training workers and disrupting current production whilst being implemented | | Higher employee morale– workers motivated by extra responsibility, team work and involvement in decisions of TQM | Benefits may not be seen for several years | | Lower costs – Decrease waste as fewer defective products and no need for separate  Quality Control inspectors | Workers may be resistant to change – may feel less secure in jobs |   There is no guarantee that TQM will be a success and there have been cases of firms abandoning their new TQM initiatives. This is often because after several years the benefits have not yet been fully achieved and have not offset the initial costs. The success of TQM will depend upon the attitudes of workers throughout the business and how readily they accept the changes to their traditional working practices. | |
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| **Production** | |
| **Subject: Production** |  |
| **Topic: Stock control** | |
| There are three types of stock that a business can hold:  **Stocks of raw materials** (inputs brought from suppliers waiting to be used in the production process)  **Work in progress** (incomplete products still in the process of being made)  **Stocks of finished products** (finished goods of acceptable quality waiting to be sold to customers)  The aim of stock control is to **minimise the cost of holding these stocks** whilst ensuring that there are **enough materials** for production to continue and be able to meet customer demand. Obtaining the correct balance is not easy and the stock control department will work closely with the purchasing and marketing departments.  The marketing department should be able to provide sales forecasts for the coming weeks or months (this can be difficult if demand is seasonal or prone to unexpected fluctuation) and so allow stock control managers to judge the type, quantity and timing of stocks needed.  It is the purchasing department’s responsibility to order the correct quantity and quality of these inputs, at a competitive price and from a reliable supplier who will deliver on time.  As it is difficult to ensure that a business has exactly the correct amount of stock at any one time, the majority of firms will hold buffer stock. This is the “safe” amount of stock that needs to be held to cover unforeseen rises in demand or problems of reordering supplies.  **Stock management**  Good stock management by a firm will lower costs, improve efficiency and ensure production can meet fluctuations in customer demand. It will give the firm a competitive advantage as more efficient production can feed through to lower prices and also customers should always be satisfied as products will be available on demand.  However, poor stock control can lead to problems associated with **overstocking** or **stock-outs**.  If a business holds too much **buffer stock** (stock held in reserve) or overestimates the level of demand for its products, then it will **overstock**. Overstocking increase costs for businesses as holding stocks are an expense for firms for several reasons.   * Increases warehouse space needed * Higher insurance costs needed * Higher security costs needed to prevent theft * Stocks may be damaged, become obsolete or perish (go out of date) * Money spent buying the stocks could have been better spent elsewhere   The opposite of an overstock is a **stock-out**. This occurs when a businesses runs out of stocks. This can have severe consequences for the business:  Loss of production (with workers still having to be paid but no products being produced)  Potential loss of sales or missed orders. This can harm the reputation of the business.  In these circumstances a business may choose to increase the amount of stock they hold in reserve (buffer stock). There are advantages and disadvantages of increasing the stock level.   |  |  | | --- | --- | | **Advantages** | **Disadvantages** | | Can meet sudden changes in demand | Costs of storage – rent and insurance | | Less chance of loss of production time because of stock outs | Money tied up in stocks not being used elsewhere in the business | | Can take advantage of bulk buying economies of scale | Large stocks subject to deterioration and theft | | |
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