

# Critical issues in business success and failure

## 13.1 Introduction

When a business commences operation, the SME owner/manager is optimistic of success. Most businesspeople are aware of the general pitfalls, but all businesses — regardless of their size or function — must pay close attention to a number of critical issues. These issues include:

- having a business plan
- managing employees
- analysing trends
- identifying and sustaining competitive advantage
- avoiding overextension of financing and other resources
- using technology
- considering economic conditions.

While there are many reasons for business failure (see chapter 4), careful attention to the above factors will allow businesses to avoid failure and achieve success. These critical issues form the basis for discussion in this chapter.

## 13.2 Importance of a business plan

The vital point of the previous chapter was that all business owners must take time to develop a business plan (see figure 13.1). Chapter 12 also introduced you to the planning process and the activities to be undertaken to prepare the business plan. No two business plans will be identical but they should all contain some common information. Some plans will be structured and detailed; others will be less complex and more informal. However, regardless of its format, a plan must contain reliable and accurate information in enough detail to be valid.

The business plan should contain:

1. a clear, concise statement of the goals of the business — what the business wants to achieve
2. well-developed plans for achieving these goals — how the business is going to achieve the goals
3. reliable control standards for measuring performance — has the business achieved the goals; if not, what needs to be changed?

A comprehensive plan is essential for business success.

As outlined in chapter 12, the business plan is the 'blueprint' for future growth and development within a business. It sets out the desired goals and direction of the business. It is widely accepted that a business plan is essential to long-term success and necessary for all businesses regardless of their size or function. If prospective business owners neglect to develop a business plan or make profit projections, business failure is distinctly possible because there is no clear understanding of the business's future.

Lack of planning can be as disastrous as a lack of capital. In all businesses, the best results come from effective management. This means that the manager uses the business plan and, more importantly, adjusts the plan when changes occur.



'The business plan is a written summary and evaluation of all the research and thinking a SME owner has done in the development of a business idea. It is organised in such a way that all the factors necessary for the success of the business – operations, finance, marketing and human resources – have been adequately covered. A detailed business plan greatly increases the chance of success.'

**FIGURE 13.1** An effective business plan contains a number of important elements that will make the plan an operating tool that assists in the management of the business.

## Business plan: presentation and preparation

All business plans should be presented in a professional manner, because they may be read by bank managers, accountants, financial advisers, company directors, potential purchasers or interested partners. These people often have first contact with the details of the business via the business plan, so it is important that the plan reflects the skills and abilities of the business owner. A poorly presented plan will convey the impression that little thought has been given to the planning process. This will reflect poorly on the business owner and their capabilities of getting the business 'up and running'. Sometimes it is a good idea to get professional help from an accountant, business adviser, solicitor or marketing consultant, particularly with plan elements such as the projected profit and loss statements, break-even analysis and market research.

Preparing a business plan is similar to completing an assessable task. The final result will reflect the amount of time, effort and research that goes into the plan and its final presentation. Any task that is completed quickly and at the last minute will probably lead to poor performance. But businesspeople who use the planning process effectively will end up with a valuable working document that will help guarantee a business's success.

### BizFACT



*Accuracy and realistic expectations are crucial to an effective business plan. It is unethical to deceive investors and financiers, and it is unwise to deceive oneself.*

## 13.3 Management — staffing and teams

As outlined in chapter 5, management can be traditionally described as being concerned with coordinating a business's resources to achieve its goals. More contemporary descriptions highlight that management is the process of working with and through other people to achieve the goals of the business in a rapidly changing environment. What both these explanations have in common is that management:

- must make the best use of limited resources
- is responsible for the business achieving its goals.

Think of a manager's role as being similar to that of a chef whose task is to efficiently combine the resources (ingredients) to effectively achieve a goal (a delicious meal). A skilled, competent chef could probably deliver an appetising meal even with limited resources; whereas an unskilled, incompetent chef would probably serve up an unappealing meal even if he or she had access to superb ingredients. The chef's level of skill (ability) is the critical factor determining how well the goal is achieved.



**FIGURE 13.2** While it helps to have access to high quality ingredients (resources), the success of a meal — one that is appetising and delicious — will mainly depend on the skills and knowledge of the chef.

It is the same for the management of a business. A manager's skill is the most critical factor in determining a business's success or failure. For example, a business may have the most up-to-date computer equipment, well-furnished offices, access to adequate sources of finance, a committed and motivated group of employees, an excellent location, and an outstanding range of goods or services backed up by a highly-expensive marketing campaign, but if it fails to have a competent manager(s), who can make effective and efficient use of these resources, then the business will not succeed.

Overall, the most important accomplishments a skilful manager will achieve for a business include the ability to:

- solve difficult problems
- set and help attain important goals

- develop attitudes of commitment and ownership
- create a positive business culture through their words and actions
- monitor the business's external and internal environments
- plan and allocate resources
- coordinate teams and departments
- monitor the performance of teams and individuals
- successfully put workplace and business changes into action
- develop and implement schedules and operating plans.

Two important areas of business that a manager must pay special attention to are staffing and teamwork.

## Staffing

If a SME owner wants the business to succeed, then it is essential to have employees who are satisfied and motivated (as was outlined in chapters 6 and 8), as they will be more productive. They also provide the business with a competitive advantage, especially if the business offers a service where the customers come into direct contact with the employees. Therefore, the management of the staffing function — the recruiting, selecting, maintaining, training and separating of employees — must be undertaken with care.

### Bartlett Constructions — matching staff to the business

It is especially crucial for the small business owner to select employees whose business approach complements that of the business. This is a philosophy that Guy Bartlett, founder of domestic building company Bartlett Constructions has passionately adopted since he commenced his business. Guy takes great care in recruiting and selecting the most suitable employees.

Guy started Bartlett Constructions six years ago. What started out as a two-person operation has now grown to a business employing five staff members. The quality of the work performed by Bartlett Construction's employees is largely responsible for the business's success. According to Guy, this is the main reason that his employees must be 'the best in the business': 'I can supply the equipment and training but I can't do it all by myself. I rely on having a committed team of people who enjoy their work and gain satisfaction from a job well done. My staff members really are my greatest resource. The high quality of their work has enabled the business to gain an excellent reputation within the district.'

'I like to think of my staff as working with me, not for me. We are one team and all responsible for the long-term success of the business.' Currently, Bartlett Constructions employs four licensed builders, one apprentice and one part-time office assistant.

Guy encourages his employees to gain extra qualifications, and he provides financial assistance for course fees, materials and study days. 'For example, one of my builders recently attended a customer service training session at the local TAFE college. It is important for all staff to realise they are responsible for professional customer service; not just the office assistant. An employee's willingness to learn and to work as part of a team are two important personal qualities I look for when selecting new staff.'

#### Snapshot questions

1. **Outline** why Guy Bartlett believes staff are his greatest resource.
2. **Assess** the impact Guy Bartlett's approach to human resource management would have on his employees.



## SNAPSHOT



'I like to think of my staff as working with me, not for me.'

One mistake that some SME owners often make is not providing enough time or financial resources to satisfactorily carry out the recruitment process. Making hasty recruitment and selection decisions often ends in misfortune for both the SME owner and the employee. For this reason, many SME owners outsource this function and use an external recruitment agency.

### External recruitment

It is time consuming to advertise, screen and interview potential employees. Many businesses use recruitment agencies as a way of decreasing the time involved in searching for a new employee. They pay an agency to interview candidates and recommend a shortlist of potential employees or an employee suitable for the available position. Outsourcing of staff recruitment is becoming popular with small businesses, especially as the skill shortage worsens and owners see the advantage of using an expert to make sure they hire the best people.

A community employment agency such as Mission Australia Employment Services is one of the most common sources of employees for business. Mission Australia competes with other mainstream recruitment agencies for government contracts. Their recruitment service is provided at no charge to businesses.

#### eBookplus

##### Weblink

Use the **Mission Australia Employment Services** weblink in your eBookPLUS to visit the website of Mission Australia Employment Services.



**FIGURE 13.3** Mission Australia Employment Services will attract and screen candidates — including apprentices and traineeships — without the expense of using a private recruitment agency.

### Employee skills databases

Once people have been employed, the next important staffing management function is to achieve the right mix and level of employees' skills. This is best accomplished by using a skills audit and skills inventory.

#### Skills audit

It is important for any business to detail the current skills base of the people involved in the business, as well as identifying any skills needed in the future. A personnel skills audit is used for this purpose. A **skills audit** is a process that establishes the current skills levels of employees and future skills requirements.

The aim of the audit is to identify:

- the skills that will give the business a competitive advantage
- weaknesses in the skills base which, unless overcome by training or recruitment, will threaten the business's survival.

Figure 13.4 provides an example of a skills audit form. One form should be completed for each employee. Once this information is collected, it can be used



#### BizWORD

A **skills audit** is a process that establishes the current skills levels of employees and future skills requirements.

to produce a skills inventory — that is, a computerised database containing information on the skills and experiences of all present employees.

EMPLOYEE SKILLS AUDIT FORM			
			Date _____
Employee	Personal experience	Current skills	Future skill requirements

**FIGURE 13.4** Skills audit form

### Skills inventory

An employee database is an important tool used by business owners for recording personal and work details of their employees. This type of database should be regularly updated as new employees join the business and existing ones leave. One particular type of employee database is the skills inventory. A **skills inventory** is a database containing information on the skills, abilities and qualifications of existing staff. It is used to search for appropriate candidates to fill new positions within the business. For example, a business may be seeking a current employee with a commerce or business-related tertiary qualification, at least 10 years' experience, fluency in Japanese, and with some knowledge of marketing. By accessing the skills inventory, a search can quickly identify employees who match these specifications.

## Teams

As was outlined in chapter 7, many businesses are starting to realise that a team approach can be a catalyst for superior performance. Teams are replacing individuals as the basic building blocks of businesses of all sizes, especially in those businesses that are adopting flatter organisational structures.

Businesses are learning that teams:

- make more informed and creative decisions
- work without the need for close supervision
- create greater levels of employee cooperation
- provide improved customer service and/or production output.

How teams are managed, therefore, is another critical issue determining business success. However, it can sometimes be difficult for SME owners to have the time or expertise to develop highly functioning teams or improve the communication and efficiency of already established teams. Consequently, many SME owners are seeking professional help from training and coaching businesses. By investing time and money in the development and training of team leaders and team members, the business reaps the rewards of improved productivity (see the following Snapshot).



### BizWORD

A **skills inventory** is a database containing information on the skills, abilities and qualifications of existing staff.



### BizFACT

One undesirable consequence of team (group) cohesiveness is the problem of groupthink: blind conformity in unified in-groups. Groupthink helps explain why intelligent people can sometimes make incredibly unwise decisions.



## SNAPSHOT



‘To build a great business, you must build great teams.’

### CompuWorks — productive teamwork

Don Russell, owner of CompuWorks, has a favourite saying: ‘To build a great business, you must build great teams.’ However, Don was faced with a dilemma. ‘I wanted the four teams within the business to become more self-directing. Because I was so busy dealing with the daily problems that cropped up, I was not able to stand back and work out how to achieve this.’

Not being able to devote enough time to strategic planning is a problem faced by many SME owners. Don decided to hire the training company New Vision Pty Ltd to work with the teams. ‘As the owner of a medium-sized business, I feel the pressure to continually generate the entrepreneurial energy. What I wanted was for the teams to create ideas and explore different ways of solving problems. This would help lift productivity by reducing the number of production problems.’

Working with New Vision showed Don and the team leaders the importance of setting clear, realistic and attainable goals. Each team was given the responsibility for setting production targets and mutually beneficial outcomes for team members and the business.

‘One of the most important changes we introduced was regular, informal meetings where all team members are allowed to participate. We call these sessions “participate and review” sessions. At these meetings we acknowledge what teams have done well, how productivity might improve and set monthly goals.’

‘These new procedures have so far proved successful with the average productivity rising by 9 per cent. Not all employees were happy with the changes and three employees resigned. However, the majority of employees report feeling more motivated and satisfied.’

#### Snapshot questions

1. **State** what changes were introduced to make the teams more productive.
2. **Recall** why Don Russell decided to hire the services of a training company.
3. **Explain** what is meant by the phrase ‘To build a great business, you must build great teams’.
4. **Determine** why many SME owners are not able to devote enough time to strategic planning. Share your answer with other class members.

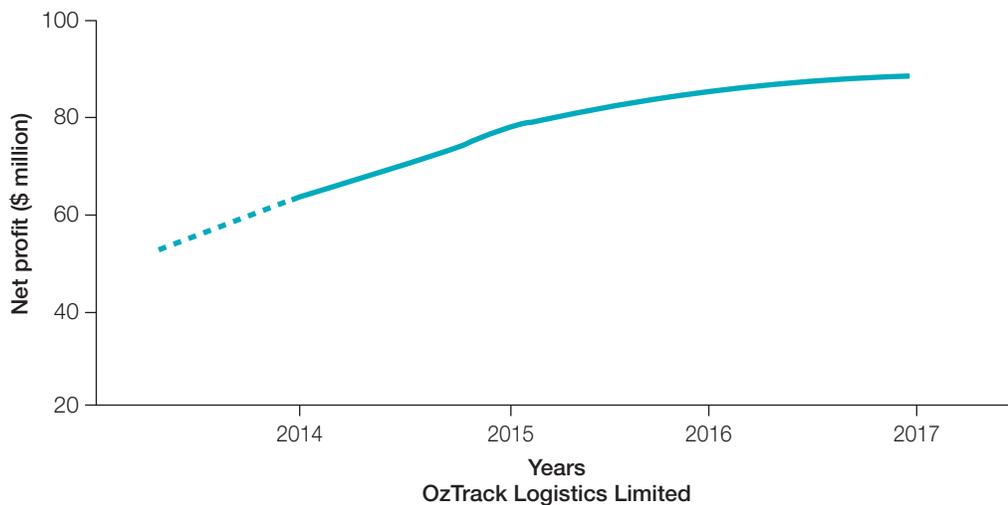
## 13.4 Trend analysis

Examine table 13.1 below. What do you notice about the business’s net profit results?

**TABLE 13.1** Net profit results for OzTrack Logistics Limited 2014–17

OzTrack Logistics Limited	
Year	Net profit (\$ million)
2014	62
2015	78
2016	85
2017	90

On a quick inspection, you would say that net profit is increasing over the four years. However, upon closer examination, you will detect that the rate of net profit growth is decreasing; that is, net profit is increasing but at a decreasing rate. This *trend* is best shown by graphing the net profit results (see figure 13.5). As a business owner, such a trend could be cause for alarm because it could mean that future net profit may fall.



**FIGURE 13.5** OzTrack Logistics Limited net profit results 2014–17

Trend analysis is a process of investigating changes over time and looking for a pattern (trend) in order to predict the future. Trend analysis is based on the idea that what happened in the past provides an idea of what will happen in the future. For example, as a student you probably keep a record of your grades for each assessable task or test. You do this to determine whether your grades are generally rising, falling or stable. Analysing this information also allows you to predict what mark you will receive for a future assessable task or test. You will base your prediction on past performance. The more past grades you have to examine, the more accurate your prediction will be.

Trend analysis is a powerful tool which, when used properly, will assist SME owners to achieve business success by helping forecast such factors as:

- potential sales
- total revenue
- total operating costs
- gross and net profits
- availability of labour.

As was outlined in chapter 12, forecasts are needed to enable effective planning, and trend analysis helps make forecasting more accurate. Overall, trend analysis will provide more reliable information on which a SME owner can base decisions. If, for example, a retailer's trend analysis of past sales forecasts sales to decrease, then appropriate strategies — such as new products or a revamped marketing campaign — can be put in place to avoid the poor performance.

## Summary

- Business plans are essential for owners/managers because:
  - they allow the owner to clearly define the goals and future projections (e.g. finance)
  - they assist in the securing of finance from banking institutions or investors
  - they reflect the skills and abilities of the business owner.
- Management:
  - must make the best use of limited resources
  - is responsible for the business achieving its goals.
- A manager's skill is the most critical factor in determining a business's success or failure.



### BizFACT

*Examinations of a business's financial information or total sales are two of the most common applications of trend analysis.*



**EXERCISE**  
13.1

- If a SME owner wants the business to succeed, then it is essential to have employees who are satisfied and motivated as they will be more productive.
- Outsourcing of staff recruitment is becoming popular with SME owners.
- Teams are replacing individuals as the basic building blocks of businesses of all sizes especially in those businesses that are adopting flatter organisational structures.
- How teams are managed is another critical issue determining business success.
- Trend analysis is a process of investigating changes over time and looking for a pattern (trend) in order to predict the future.
- Trend analysis is a powerful tool which assists SME owners achieve business success by helping with forecasts.

## Revision

- 1 **Explain** the purpose of a business plan.
- 2 **Recall** why a business plan should be professionally presented.
- 3 **State** what the traditional and contemporary description of management have in common.
- 4 'To be successful, every business needs skilled managers.' **Discuss**.
- 5 **Identify** one advantage and one disadvantage of using a private external recruitment agency.
- 6 **Account** for why businesses of all sizes outsource their recruitment function.
- 7 **State** three benefits of working in teams.
- 8 **Define** the term 'trend analysis'.
- 9 **Demonstrate** how you, as a student, could benefit from using a trend analysis.
- 10 **Examine** figure 13.5 (page 421) and **explain** why it is easier to identify a trend when using a graph rather than a table of figures.

## Extension

- 1 Referring to a business you have studied, answer the following questions.
  - (a) **Investigate** the planning options that had to be considered when the business was established.
  - (b) **Examine** what essential components were included in the business plan.
  - (c) **Determine** how important the business plan was to the overall success of the business.
- 2 'The output of teamwork is, in many instances, greater than the combined output of its individual members working alone.' **Assess** the accuracy of this statement.
- 3 'A favourite method of forecasting is to base the estimate entirely on past sales.' **Investigate** the advantages and disadvantages of using this method to predict future sales.

## 13.5 Identifying and sustaining competitive advantage

Business success and failure is linked (in the long term) to a business's ability to develop a strategy that allows it to gain an advantage over other competitors in its market. A **competitive advantage** can be defined as the strategies used by a business to ensure it has an 'edge' over its competitors. A business cannot always sustain above-average performances in all areas for long periods. For this reason, it must choose a strategy (outlined below) that will allow it to use and develop its strengths as a business. This strategy can give the business a competitive advantage.



### BizWORD

**Competitive advantage** refers to the strategies used by a business to gain an 'edge' over its competitors.

## Price/cost strategy

The price/cost strategy requires the business to be serious in terms of wanting to be the leader within its industry. The business does not just compete with others, but leads the way by achieving the lowest production costs, which in turn allow it to reduce the product price. While the price is lower, it is important not to compromise the product's quality in relation to that of competitors' products. Figure 13.6 suggests the main ways in which to develop a cost advantage over competitors.

Efficiency of operation refers to the ability of a business to streamline the processes that occur within that business. A manufacturing business, for example, may use more machinery or perhaps specialise parts of the production line (where one operator completes one part of a process, such as placing finished products into boxes while someone else loads the boxes onto the transport).

Low-cost labour is an obvious way to gain a cost advantage over the competition. In Australia, labour is one of the most expensive components of the production process because minimum wages are set by the government. The union movement has fought for these requirements over the past 100 years. They include minimum wages and working conditions, as well as holiday and sick leave entitlements (as outlined in chapter 8).

Economies of scale can achieve a cost advantage for the firm. Simply, this concept relates to the level of outputs for a business and the cost of the inputs (for example, the cost of labour or raw material). To achieve economies of scale, the business tries to reduce the cost of inputs — perhaps by using more machinery, buying in bulk or increasing the specialisation of labour — and increase the level of outputs.



### BizFACT

*Labour costs in Australia per unit of output have grown by 3.25 per cent per year over the last decade. In the United States the increase was 1.9 per cent and in Germany only 0.5 per cent over the same period.*



**FIGURE 13.6** How to develop a cost advantage over your competitors

Many businesses attempt to reduce the cost of labour by decreasing the size of their workforce and using machinery where possible. Other companies choose to move their operations to countries where labour costs are low. Some countries, such as China, require employers to pay only small wages, so a firm in a labour-intensive industry (such as the clothing and textiles industry) may choose to relocate this part of its operations overseas.

The final way to develop a cost advantage over the competition is to use technology. Nearly all businesses today have found that technology — whether computerisation or the use of automation and robotics — has enabled them to improve efficiency and production. As a result, a business can reduce its overall costs. This is obvious in the car manufacturing industry where computers and machinery have gradually replaced labour.

The changes are more subtle, however, in a service industry: they may include, for instance, the computerisation of client information, or the use of advanced communication mediums such as the internet or email.

## Differentiation strategy

The concept behind this strategy is to offer customers something that is not already offered by business rivals. The differentiation could be high product quality, innovative design, positive brand image or top-quality service.



### SNAPSHOT



• very competitive from a cost point of view •

### Patties Foods — competing on cost

Patties Foods is one of Australia's leading branded frozen food companies. The business, which owns popular brands such as Four'N Twenty, Nanna's and Herbert Adams, has achieved a competitive advantage using a price/cost strategy as well as differentiation.

In their 60th year in business, instead of outsourcing their operations, Patties Foods made the decision to become more competitive by increasing the production capacity of their facility. This efficiency of operation enabled them to achieve economies of scale. The company invested \$21 million in product innovation by purchasing the world's best practice pastry-making equipment in an attempt to increase production. Patties Foods added two new pie lines and a 10 000 pallet freezer warehouse at the company's bakery in Victoria. This investment allowed the company to increase production to 38 000 pies per hour. Patties Foods have also recently invested another \$10 million in automation so that on one of their product lines, their products will be packed using robots.

In addition to competing on cost, Patties Foods has also sought to achieve a competitive advantage through promoting their iconic Australian brand name and through their investment in marketing and the development of unique advertising campaigns. The company has also been able to increase sales by innovating with new products every year.

Patties Foods increased their revenue by 8.8 per cent to \$19.5 million in 2012, at a time when most food manufacturers were struggling. The increase in production and improved efficiency has also made it possible for the company to begin pursuing an exporting strategy.

Patties Foods began as a family run bakery more than 60 years ago. Identifying and sustaining a competitive advantage through a variety of strategies led the company to become one of the biggest pie bakeries in the world. The managers believe the key to their success has been their investment in new technologies, which allowed the company to become more efficient and very competitive from a cost point of view.

### Snapshot questions

1. **Outline** how Patties Foods has achieved a competitive advantage through pursuing a price/cost strategy.
2. **Describe** how Patties Foods has attempted to differentiate themselves from their competitors.

Many businesses adopt a range of strategies to develop and enhance differences in their product. An example of this strategy is the use of celebrities to endorse and contribute to a product's image, such as Beyonce's association with Pepsi and Justin Bieber's endorsement of Proactiv.

Once a business achieves its product differentiation strategy, the challenge then is to sustain this competitive advantage, especially as competitors attempt to match this strategy.

## Ensuring long-term success

Long-term success can be difficult to achieve if a business is unable to develop a competitive advantage. The business may succeed for a short period, but often only because other businesses in the same industry are not striving for any sort of advantage so they all exist at the same level.

Sustaining a competitive advantage is just as important as developing that advantage. Long-term success is assured if a business sustains its competitive edge. The business must be able to resist the actions of competitors who introduce new strategies, while also tracking changes within the industry (especially technological changes).

To limit the advances of competitors, a business must protect itself and reduce opportunities available to the competitors. This may be achieved through:

- research and development, which helps the business develop innovative products
- patents/copyrights, which protect against copying of inventions
- exclusive contracts with suppliers, which mean a supplier gives preference to the business
- lobbying government to limit foreign competition, which aims to restrict imported products.

Most importantly, for a business to sustain a competitive advantage, the actions of management must be dynamic. Staying in front of the competition requires constant action. All businesses operate in a constantly changing environment. The owner/manager must be constantly aware of issues that may affect their operation, market share and profit. If a business is not looking to the future and its impact, then its competitors will be. To sustain a competitive advantage, a manager must be able to predict changes and trends, and act on these predictions.

## Summary

- Business success and failure is linked (in the long term) to a business's ability to develop a strategy that allows it to gain a competitive advantage over other competitors in the market.
- A competitive advantage refers to a business's ability to gain an 'edge' over its competitors.
- A competitive advantage is achieved through:
  - *price/cost strategy*. This is best accomplished by achieving the lowest production costs, which in turn allow it to reduce the product price.

- *differentiation strategy*. The concept behind this strategy is to offer customers something that is not already offered by business rivals.
- *ensuring long-term success*. This is assured if a business sustains its competitive edge by limiting the advances of competitors.
- A price/cost competitive advantage is best achieved by:
  - efficiency of operation
  - low-labour costs
  - economies of scale
  - technology.
- For a business to sustain a competitive advantage, the actions of management must be dynamic.



## Revision

- 1 **Explain** competitive advantage and how a business can try to achieve it.
- 2 (a) **Explain** cost advantage.  
(b) **Discuss** why it is considered important to a business trying to achieve a competitive advantage.
- 3 **Outline** the differentiation strategy in terms of achieving a competitive advantage.
- 4 **Identify** three examples of businesses that may use the differentiation strategy.
- 5 **Explain** what is meant by a sustainable competitive advantage.
- 6 **Outline** how a business can limit the advances of its competitors.

## Extension

'All businesses must be able to achieve a competitive advantage if they wish to succeed.'  
**Assess** the accuracy of this statement.

## 13.6 Avoiding overextension of financing and other resources

Ideally, those financing a business should start small and gradually expand. Unfortunately, some business owners overextend their capacity in the establishment or takeover stage, resulting in excess expenditure that is financed primarily by external sources such as banks. A business can overextend financially by:

- using hire purchase and/or leasing commitments made on:
  - cars
  - equipment
  - office furniture
  - plant and machinery
  - the premises.
- purchasing excess stock
- employing too many staff for the business's current needs.

These types of expenditures are fixed, which means the business has a lease contract that is valid for a certain period (such as one or two years). This can create a higher degree of business risk. If economic conditions weaken, for example, businesses that are highly geared (that is, they have a higher debt-to-equity ratio) come under greater financial pressure and are more susceptible to bankruptcy.

Another expenditure problem can arise if the business owner purchases the business premises. **Leasing** is an effective option, yet many owners decide to buy premises and may find themselves overborrowing. If the business cannot meet its capital and interest repayments, then its working capital will also be affected.



### BizWORD

**Leasing** is a long-term source of borrowing for businesses. It involves the payment of money for the use of equipment that is owned by another party.

There are many tips for a business of any size and type to avoid overextending financially, including:

- *business planning*. This involves the completion of cash flow projections, preliminary establishment costs, personal financial budgets and financial statements of position, along with the setting of the business's goals and objectives.
- *avoiding an overdependence on debt financing*. This helps avoid problems during weak economic periods when lenders or creditors are unwilling to wait for the business to overcome difficulties.
- *long-term financial planning*. This concerns not just the current financial aspects of the business, but anticipating future problems and planning the business's direction in terms of growth and expansion.
- *a small start*. Many businesses 'walk before they crawl' and quickly find themselves in difficulty. It is important to start slowly and allow the market to determine the right times for expansion and growth.

## Overextension of other resources

Finance is not the only area in which a business can overextend. A business can also overcommit to resources. Resources refer to the inputs necessary for a business to carry out its function. The following two factors have the potential for problems if they are not monitored by management.

### Stock

A business that overextends in terms of stock has invested too much money in goods or raw materials. This may occur if the business anticipates customer demand incorrectly, or purchases a 'bargain' from a supplier (such as end-of-season stock) without establishing whether it is saleable among its own customers.

Stock is unrealised sales, and a business with too much stock not only ties up its own cash but potentially loses revenue. Many businesses avoid stockpiling, and prefer to keep only limited supplies and order regularly.

### Staff

A business may find itself with too many staff. This may be due to over-optimism about sales levels, or just poor job allocations and hiring. Staff are costly, but options are available for a business to decrease its dependence on this resource and reduce costs in the long term. These options include:

- outsourcing
- redefining current job descriptions
- using more equipment/machinery.

## 13.7 Using technology

Technology is having many effects on the business world. It is changing the machinery and equipment we work with, and changing the workplace environment. These changes have had a major impact on the internal and external business environments, and the extent and speed of change is likely to continue.

Advances in information technology include:

- iPhones
- BlackBerry smartphones
- Skype
- email.



### BizFACT

*Just-in-time is a method used by some firms to ensure that inventory (stock) is not lying idle. The business has an arrangement with a supplier that orders will be supplied immediately. Thus the business carries little or no inventory and relies on the supplier to fill the orders. Many major companies, including the Coca-Cola bottling plant in Australia, use this practice.*

These have reduced communication time delays and improved distance communication between colleagues, suppliers and customers. But not just information technology has advanced: robotics, machinery and equipment for production processes have allowed for faster production times, higher productivity and greater flexibility, which in turn reduce overall costs.

There is little hope for a business that is not prepared to use some forms of technology. Figure 13.7 illustrates some of the technology available for all types of businesses.



**BizFACT**

Many businesses are using social networking sites such as Twitter and Facebook to communicate with their customers.

**FIGURE 13.7** Examples of the technology available to business

## Internet applications (e-business and e-commerce)

Over the past decade, there has been an explosion in electronic business, largely brought about by the development of the internet. The internet, a giant computer network connecting millions of computers around the world, has revolutionised the way in which small business owners both access information and do business — e-business and e-commerce.

## Accessing electronic information services via the internet

One of the main advantages of accessing material electronically is that specific information can be located quickly, 24 hours a day, seven days a week. An electronic search is relatively inexpensive and fast. Such a search can also be designed to answer individual requests. These individual requests may include:

- legal requirements for starting a business or changing the formation of a business
- techniques for marketing a good or service
- changes to business administrative requirements, such as taxation changes
- current requirements for industrial relations, such as award conditions
- work health and safety requirements
- support from government agencies, such as Austrade or the Australian Taxation Office.

However, there are some disadvantages, including:

- expense in terms of hardware, software and service provider charges
- slowness to display web pages
- corruption by a virus
- unwanted spam
- information overload.

## E-business

**E-business** (electronic business) is using the internet to conduct business. It occurs when a business:

- uses the internet to find information — such as suppliers, prices and product details — and to keep track of delivery schedules
- uses email to communicate with customers and suppliers
- uses the internet for online working and paying of accounts
- uses the internet to research market conditions, industry trends and economic forecasts
- uses its website to market its goods and services
- uses the internet to lodge forms or apply for licences via a government department's website.



### BizFACT

The term 'Web 2.0' refers to the transformation of the World Wide Web into a more creative and interactive platform for information sharing, rather than just a means of retrieving information.



### BizWORD

**E-business** (electronic business) is using the internet to conduct business.



**FIGURE 13.8** E-business can bring a range of competitive advantages to the small business owner.



## SNAPSHOT

Remember, online businesses need to be maintained as much as traditional shopfront outlets.



## BizWORD

**E-commerce** is the buying and selling of goods and services via the internet.

## Online businesses — steps in setting up



You've got the computer and the brilliant business idea, now it's time to get your e-business running.

The first step is choosing an internet service provider (ISP). It's a good idea to choose one that is in a city near you, is business-focused, runs a help desk and provides training if necessary. Be wary of a low price; it may mean it won't provide all the services you require.

You can now choose your domain name. Domain names allow potential customers to type in a website address to access your site.

If you wish to buy a .com.au or .net.au domain name, you must be a commercial entity and possess either an ACN or ABN, which you can apply for from the Australian Taxation Office.

When you choose a name, it has to be registered through a registrar and a fee must be paid to protect the name. Registration companies will set up your domain name so it can be accessed on the internet.

You can now start thinking about your website and how it looks and operates. Some ISP providers can help you with this or you can use a specialist website design organisation. If you're tech-savvy, try doing it yourself using a software package or some of the free design platforms that are now available.

If you want your customers to pay online for your product or service, you will also need a merchant services agreement with a bank. You will have to make sure the services offered by your bank and your ISP are compatible.

Remember, online businesses need to be maintained as much as traditional shopfront outlets.

*Source: K. Cambourne, 'Setting up is as easy as ISP', The Age, 1 December 2010.*

### Snapshot question

**Outline** the steps involved in starting an e-business.

## E-commerce

The term **e-commerce** (electronic commerce) has a narrower meaning than that of e-business. It refers to the buying and selling of goods and services via the internet — it is a part of e-business. Today consumers expect a business to have an online presence. In response, more Australian small businesses are using the internet to cover all aspects of e-commerce.

Due to the perceived cost and complexity of e-commerce, some small business owners are tentative in their use of it. Apart from having an email facility and a website, they do not make full use of the technology and consequently do not realise its full potential.

## 13.8 Economic conditions

As outlined in chapter 3, section 3.3, a nation's economy will go through fluctuations; it will experience good times — booms — and downturns — recessions. The economic conditions are an aspect of the external business environment in which the business has no control.

Changes in the economic conditions in the economy have the ability to impact dramatically on a business in regards to success and failure.

## Economic conditions that promote business success

When an economy is in a boom, it will most likely mean that consumers are prepared to increase their spending because consumer confidence is high. Consumers are certain their jobs are secure and incomes are expected to increase; they have an optimistic outlook.

In periods of strong economic activity the economy will experience:

- high levels of consumer spending. This will mean businesses have a greater capacity to sell goods and services and therefore profits are maintained and improved. Businesses that sell more luxury type goods and services (such as brand clothing, jewellery and imported cars) will benefit in this type of economic condition because the consumer has a higher level of disposable income.
- falling unemployment. Unemployment is lower as businesses can afford to hire more employees when sales and profits are steady and growing. As well, to meet the increased demand for goods and services, businesses will be required to increase the size of their workforce.
- increased production. Businesses' output will increase to meet buoyant trends that provide opportunities for future increased sales and profit.

## Economic conditions that lead to business failure

When an economy is in a downturn, it will most likely mean that consumers are not spending as much. This is because consumer confidence is low. Consumers fear they may lose their job or their wages may not increase. Overall, reduced consumer spending translates to reduced profits for business. This will eventually lead businesses to reducing their production levels.

In periods of weak economic activity the economy will experience:

- lower levels of consumer spending. This will mean businesses have a reduced capacity to sell goods and services and therefore profits will decline. Businesses that sell more necessities and budget-type goods and services (such as groceries and cheaper clothing) will benefit in this type of economic condition. This is because consumers become more cost conscious and will seek out goods and services they consider to be value for money.
- rising unemployment. Unemployment is higher as businesses cannot support current employee numbers when sales and profits are decreasing or negative. As well, cutting back production levels may reduce inventories of goods and services that are potentially unsaleable. Consequently, existing employees may be made redundant.
- decreased production. Businesses' output will decrease in response to the fall in consumer spending. As a result, profits will also decrease.

## Summary

- A business can overextend financially by:
  - hire purchase or leasing overcommitments
  - purchasing excess stock
  - employing too many staff for the business's current needs.



### BizFACT

*The Consumer Sentiment Index is a measure of consumer confidence in Australia. It is based on a survey of over 1200 households. When the index scores above 100, it indicates that the number of optimists outweighs the number of pessimists.*

### eBookplus

#### Weblink

Use the **Economic news** weblink in your eBookPLUS to explore the latest news on the Australian economy.

- Overextending expenditure can create a high degree of business risk.
- To avoid overextending financially, a business should:
  - undertake thorough planning
  - avoid overdependence on debt financing
  - engage in long-term financial planning
  - grow at a sustainable rate.
- Overextension of stock ties up a business's cash and can lose revenue.
- Overextension of staff results in employing too many staff.
- The integration of technology into the business is essential to succeed in contemporary society.
- E-business (electronic business) is using the internet to conduct business.
- E-commerce (electronic commerce) is the buying and selling of goods and services via the internet.
- A nation's economy will experience periods of boom and recession.
- In periods of strong economic activity, consumer spending, sales of goods and services, production and profits are rising.
- In periods of weak economic activity, consumer spending, sales of goods and services, production and profits are falling.

### EXERCISE 13.3



#### eBook<sup>plus</sup>

##### Weblinks

Yahoo! Australia, Amazon and ninemsn Shopping

#### eBook<sup>plus</sup>

##### Digital doc:

Use the **Chapter summary** document in your eBookPLUS to compile your own notes for this chapter.

**Searchlight: DOC-14122**

## Revision

- 1 **Identify** the main ways in which a business can overextend financially.
- 2 **Outline** how a business can protect against overextending its finances.
- 3 **Explain** why technology is so crucial in terms of business success and failure.
- 4 **Distinguish** between e-business and e-commerce. Provide two examples of each.
- 5 Select and **explain** two advantages and two disadvantages (for a business) of using the internet to access information.
- 6 Use the **Yahoo! Australia, Amazon** and **ninemsn Shopping** weblinks in your eBookPLUS to **investigate** the operation of the large e-tailers. Evaluate the three sites, reporting on:
  - (a) the ease of navigation
  - (b) the layout of the home page
  - (c) methods of payment
  - (d) the ease of product selection
  - (e) the return and refund policy.
- 7 **Distinguish** between an economic boom and a recession.
- 8 **Explain** the impact a period of (i) strong and (ii) weak economic growth will have upon most businesses.

## Extension

- 1 **Analyse** the importance of financial planning for short-term and long-term success in business.
- 2 'Business expansion should be slow and steady.' **Evaluate**.
- 3 'Technology has had a great impact on the internal and external business environment.' **Discuss**.
- 4 **Determine** the advantages and disadvantages of the dynamic nature of technology in Australian business.

- 5 Create** either an oral or ICT report about the internet. The following terms and phrases are a guide to the content you will need to research:
- modem
  - security and authenticity of the website
  - 3D web technology
  - universal resource locator (URL)
  - hyperlink
  - site domain name
  - internet service provider (ISP)
  - spamming privacy implications
  - What is the internet?
- 6** Arrange to interview a small business owner whose business has an online presence.
- Investigate:**
- (a) the reasons for going online
  - (b) the benefits of a web presence
  - (c) the difficulties encountered in setting up the website.

You may wish to video the interview, then watch and discuss it in class.

**eBookplus****Digital doc:**

Test your knowledge of key terms by completing the **Chapter crossword** in your eBookPLUS.

**Searchlight: DOC-1219**

## Business planning

### Multiple choice questions

- 1 Which of the following characteristics best describes an entrepreneur?
  - (a) An inventor
  - (b) A risk taker
  - (c) An academic
  - (d) A highly skilled employee
- 2 What legislation is designed to protect both consumers and businesses?
  - (a) Fair Work Act
  - (b) Small Business Act
  - (c) Consumer Affairs Act
  - (d) Competition and Consumer Act
- 3 What does equity finance refer to?
  - (a) Money obtained through loans
  - (b) Money obtained from the owner's personal funds
  - (c) Money obtained from a financial intermediary such as a bank
  - (d) Monetary or financial assistance from the government that doesn't have to be repaid
- 4 The variable cost of producing yo-yos is \$2 and management suggests that the selling price be \$5. The business expects to sell 50 000 yo-yos in the next year. Fixed costs are \$30 000. What is the break-even number of units of production of yo-yos required for next year?
  - (a) 50 000
  - (b) 10 000
  - (c) 20 000
  - (d) 30 000
- 5 What does just-in-time refer to?
  - (a) Producing goods quickly in anticipation of increased demand
  - (b) Keeping minimal stock and ordering supplies just prior to use
  - (c) Maintaining a large inventory so that goods can be delivered on time
  - (d) Avoiding industrial action at the last minute by agreeing to union demands
- 6 Which of the following statements is FALSE in relation to a business plan?
  - (a) A business plan is prepared only when the business is initially established.
  - (b) A business plan is a statement of goals for the business and the strategies taken to achieve them.
  - (c) A business plan allows stakeholders to determine the viability and profitability of the business.
  - (d) Having a business plan is a critical factor determining business success and failure.
- 7 Which of the following is considered to be an on-cost for a business?
  - (a) Wages
  - (b) Superannuation
  - (c) Staff training costs
  - (d) Goods and services tax
- 8 Which of the following would be a reason for deciding to start a new business from scratch as opposed to buying an existing business?
  - (a) Easier to obtain finance
  - (b) Equipment is available for immediate use
  - (c) Sales to existing customers will generate instant income
  - (d) The owner has the freedom to set up the business as they wish
- 9 The owners of a café have implemented policies to ensure they comply with their local government regulations. Which influence in establishing a SME are they addressing?
  - (a) Legal
  - (b) Market
  - (c) Taxation
  - (d) Sources of information

- 10 Which of the following best describes a vision statement?
- (a) It details the main purpose of the business
  - (b) It states what the business aspires to become
  - (c) It explains the role of each key business function
  - (d) It provides information of the financial stance of the business

## Short response questions

- 1 When establishing a business, the entrepreneur risks capital and personal confidence.
- (a) **Describe** the personal qualities essential to all entrepreneurs. *3 marks*
  - (b) **Discuss** entrepreneurship and its importance in terms of the development of new businesses. *6 marks*
- 2 Referring to a business you have studied, answer the following questions:
- (a) **Identify** the three personal factors that should be taken into account before establishing a new business. *3 marks*
  - (b) **Explain** what considerations are necessary when identifying business opportunities. *6 marks*
  - (c) **Determine** how a business can achieve a competitive advantage in terms of its chosen market. *12 marks*
- 3
- (a) **Define** the phrase 'identifying a business opportunity'. *2 marks*
  - (b) **Explain** its importance. *4 marks*
  - (c) **Determine** what factors need to be considered before the business idea can be developed. *8 marks*
- 4
- (a) **Define** the term 'target market' *2 marks*
  - (b) **Demonstrate** why it is essential for a business to identify its target market. *4 marks*
  - (c) Once a business has identified its target market, **recommend** three strategies the business can use to achieve a competitive advantage. *6 marks*
- 5
- (a) **Outline** the two advantages and two disadvantages of buying an existing business. *4 marks*
  - (b) **Explain** how a franchise operates. *4 marks*
  - (c) **Examine** the costs and benefits of buying a franchise. *4 marks*
  - (d) **Discuss** why franchises have become so popular in recent years. *5 marks*
- 6 Location is considered crucial in terms of business success.
- (a) **Outline** the main factors that must be considered in terms of choosing a business location. *3 marks*
  - (b) **Discuss** the differences in location choice for a manufacturing business and a retail clothing store. *6 marks*
- 7 'Government regulations are necessary for the business sector to function efficiently and equitably.'
- (a) **Describe** two of the legal requirements to which businesses must adhere. *4 marks*
  - (b) **Discuss** the accuracy of this statement and give reasons for your answer. *5 marks*
- 8
- (a) **Define** the term 'business plan' *2 marks*
  - (b) **Explain** the purpose of a business plan. *4 marks*
  - (c) **Evaluate** the importance of planning to the overall success of a business. *10 marks*
- 9
- (a) **Outline** what motivates people to start their own business. *2 marks*
  - (b) **Identify** the personal skills required to successfully operate a small business. *3 marks*
- 10
- (a) **Define** the term 'business concept'. *2 marks*
  - (b) **Explain** how a prospective business owner might devise a business concept. *4 marks*
  - (c) **Analyse** the role of innovation and entrepreneurship in the establishment of new businesses. *8 marks*
- 11 **Identify** the range of support services that small business owners should utilise. *3 marks*
- 12
- (a) **Identify** three advantages that the use of computers can bring to a small business. *3 marks*
  - (b) **Select** three different examples of business hardware and **explain** the purpose of each. *6 marks*
  - (c) **Analyse** how the use of information and communication technology can assist a small business owner to make appropriate decisions. *10 marks*

- 13** (a) **Outline** two business objectives that could be assisted by a business engaging in e-commerce. *2 marks*  
 (b) **Distinguish** between e-business and e-commerce. *4 marks*  
 (c) **Recommend** three strategies a small business could implement to increase revenue as a result of engaging in e-commerce. *6 marks*
- 14** (a) **Distinguish** between debt and equity financing. *5 marks*  
 (b) **Investigate** why funds should be borrowed for as long as it will take the increased profits to repay the loan. *6 marks*
- 15** Gerry has had an interest in antique and unusual children's toys since he was a child, and has been collecting toys from the 1940s and 1950s for many years. He is interested in setting up a toy shop, incorporating a museum or similar display for his collection. His hope is that the display of antique toys will be a means of attracting customers.  
 (a) **Identify** the source of inspiration behind Gerry's business concept. *1 mark*  
 (b) **Outline** how he has sought to differentiate his business from those of possible competitors. *3 marks*  
 (c) To assist Gerry in making a decision about whether to implement his business idea, **propose** a list of six questions that a market researcher might ask. *6 marks*  
 (d) **Create** a step-by-step process that Gerry can undertake to determine whether or not there is sufficient demand for the type of business he is proposing. *12 marks*

## Extended response questions

- 1** Research reveals that women-owned small businesses are good prospects for financial institutions that lend money. Yet women still face discrimination when organising finance and often end up borrowing from family members. **Investigate** why this discrimination still occurs.
- 2** **Discuss** the key considerations for an entrepreneur in terms of setting up a business. Use examples.

- 3** Phillip and Janice worked in a bank, but had always wanted to run their own business. While on holiday in a small seaside town, they noticed that the local general store and takeaway food shop was up for sale. The business was the only one of its type in the town, but the town is very small and seems to have a reasonably large population only during summer and holiday periods, when the local camping and caravan park, and other holiday accommodation are all full. They are very interested in purchasing the store, but realise they have to make a number of important decisions before committing to making an actual offer on the store.

As a business consultant, prepare a report that could be given to Phillip and Janice. In your report, you should:

- (a) **Outline** the main personal qualities needed to successfully operate a small business.  
 (b) **Create** a list of 10 questions Phillip and Janice should consider before committing to making an actual offer.
- 4** Referring to a business that you have studied, **determine** three critical issues that will influence the success or failure of the business.
- 5** 'Competitors can be a threat to a business but they can also ultimately lead to business success.' **Explain** how competition may in fact be good for business.
- 6** **Investigate** how the following act as the primary influences on an individual's decision to establish a business:
- |                        |                    |
|------------------------|--------------------|
| (i) personal qualities | (ii) motivation    |
| (iii) experience       | (iv) expectations. |

- 7** 'Choosing the right location was crucial because not everyone is interested in up-market garden accessories. We chose a location that had the right demographics — people took pride in their gardens and most of the people who live in the area are professional working people with cash to spend. It was also a big decision to set up our website where customers can order our garden accessories online.' Sonya Mezups, proprietor, blooming nursery.

**Explain** how selecting the correct location can make the difference between success and failure.

- 8 Select a small business that you buy from regularly and **identify** its strengths and weaknesses. If this business were for sale, **determine** whether you would consider purchasing it. Give reasons for your answer.
- 9 **Assess** the relationship between key success factors and the competitive edge that a small business should seek.
- 10 You have been employed as a business reporter with the local newspaper. You are asked to prepare an article that **examines** the number of government and private support agencies that provide assistance to small business owners. A major focus within your article should be an evaluation of two government websites that assist small businesses.
- 11 A friend wishes to go into business for herself. She is not sure whether to purchase an existing business or set up a new business. She comes to you for advice. **Outline** for her the advantages and disadvantages of each option.

- 12 Jane has just set up a small business as a wedding planner. She hopes that couples planning a wedding will commission her to put together a 'total wedding package', for which she will charge a fee. To create the type of wedding packages her customers want, she has to deal with a number of different wedding service suppliers. These include reception venues, wedding car hire businesses, photographers and video businesses, florists, printers, dressmakers and formalwear hire businesses. Jane wants to make sure she fulfils all her legal responsibilities and she wants to have a reputation as an ethical business owner, because she knows that most of her business will come from personal recommendations and word of mouth.

Jane's biggest concern is that she doesn't know whether the other businesses she has to deal with share her principles. Imagine you are her solicitor and she comes to you seeking advice. She wants to know how she can tell whether or not the wedding service suppliers she will be dealing with are acting legally and ethically, because any unlawful or inappropriate activities will reflect back on her and her business.

**Construct** a report for Jane that will help her identify whether or not her business is meeting its legal responsibilities to its customers, to other businesses and to the community. Your advice should include the following:

- how to tell whether a business is conforming to the Competition and Consumer Act
- the responsibilities of food businesses, such as reception venues, in ensuring food safety
- what Jane can do to ensure she manages her legal responsibilities in an ethical and socially responsible manner.

- 13 **Analyse** why it is important for small business owners to have a detailed understanding of the market in which the business will be competing.
- 14 'A business plan won't guarantee success but it does improve the chances of success.' **Assess** the accuracy of this statement.
- 15 'Undertaking a break-even analysis in the early stages of the planning process is crucial. The information it provides determines how I advise the client to proceed.' Nick Aquilano, small business consultant, BizVest Planning.
  - (a) **Define** the term 'break-even analysis'.
  - (b) **Explain** why it is an important planning tool.
  - (c) **Demonstrate** how to calculate the break-even point.