8.1 Introduction

So far in this topic we have discussed only the ‘what’ of management. We have examined:

- the nature of management: its importance and what skills are needed to be an effective manager
- achieving business goals: what the manager wants the business to achieve
- management approaches: ideas about different ways of performing the task of management.

However, we now come to the ‘how’ of management: how the task of management is actually done. Once a business has established a set of specific goals, the next step is to determine what needs to be done to achieve the goals. Strategies outline how the business will attempt to achieve its goals. Strategies are the series of actions undertaken to achieve an end result. This requires managers to make decisions about how best to administer and coordinate the four key business functional areas — operations, marketing, finance and human resources. This responsibility of management is often viewed as the ‘doing things right’ responsibility.

The focus of management’s strategies is to ensure that the key business functions are performing efficiently and effectively in order to support and implement the business’s overall intentions. Specialist managers in:

- operations focus on strategies to improve production processes and to create the ideal factory or office layout
- marketing determine the appropriate markets for the business’s products, and decide on pricing, product features, promotion and channels of distribution
- finance are responsible for the financial requirements, budget allocation and financial record keeping
- human resources are concerned with the recruiting, training, employment contracts and separation of the employees who are required to run the business successfully.

For example, imagine if one of Toyota’s goals is to increase its market share of hybrid motor vehicles. This would result in changes to the operations function — how the cars are manufactured. The marketing function would need to develop plans for pricing and promoting the new type of motor vehicles. Additional finance would be required to fund the extra resources needed. Finally, new employees with the necessary skills will need to be recruited and selected, or existing employees retrained.

In a small business, the key business functions are normally carried out by few employees. They are required to undertake numerous tasks that will often overlap (see figure 8.4 on page 197). Occasionally, a small business will decide to outsource one or more key business functions and concentrate on those functions in which it is most skilled. In large businesses, whole divisions or departments, such as the finance department or the marketing department staffed by many people, perform one specific function.

The key business functions are at the core of all businesses regardless of the business’s size, location, purpose or length of existence.
In most businesses, the key business functions are grouped to bring closely related tasks together. Thus, sales and marketing are grouped, finance and administration are grouped, and operations is grouped with research and development (R&D). Consequently, the range of functions is generally reduced to four main functions as is shown in figure 8.2.

These key functions are interdependent (i.e., they all overlap) and each relies on the other. In many businesses, they are separate functions. This is particularly true of large businesses. The word ‘synergy’ is often applied to describe the benefits of interdependence. Synergy means ‘the whole is greater than the sum of all the individual parts’.

**FIGURE 8.2** The four key business functions
The importance of the key functional areas is highlighted by the fact that the High School Certificate Business Studies course is structured around — and examines in more detail — the four key functional areas.

**8.2 Different ways of coordinating key business functions and resources**

Though a business can separate the key business functions into departments that perform their distinct roles, the functions are interdependent — each relies on the others to perform effectively. **Interdependence** refers to the mutual dependence that the key functions have on one another. This means that the various business functions work best when they work together. A hockey team might have highly specialised players, for instance a brilliant left wing, a superb fullback and a dynamic goalkeeper. However, despite their individual brilliance, a side will usually win when all players contribute to the game, each working with the others in the team, passing, communicating and playing for the same victory. In the same way, each section of the business may perform its specialised function extremely competently — but if they together do not work as a ‘team’ and aim for the same business goals, then the business is not likely to achieve its objectives. Interdependence occurs when each key function area is committed to the same business goals as the other key areas, and they each work in a coordinated and collaborative way to achieve these goals. Interdependence is always preferred because it provides a unified approach by the business as it works to achieve its objectives.

The coordination of key business functions depends on the broad goals of the business as well as its size. In large businesses the key business functions are often separated into different divisions or departments headed by separate managers. This is because the key functions require quite different skills and knowledge. Also, as businesses grow their needs become more complicated: they require many people to carry out each key function. This would mean that each division would have its own specialists. For example, in a large business the employment relations department would have specialists in salaries and pay, hiring of employees, staff training, work health and safety (WH&S), and so on.

The word **division** is often used by businesses to describe the separation of key functions. Division of a business along functional lines enables each part to specialise, but when the functions are separated, coordination between them becomes an important issue. In fact, the greater the divisional separation the more coordinated a business needs to be in order to run smoothly.

Most businesses are not in fact large but small. In the typical small business the work areas are not separated but often overlap. This is shown by the example of the hairdressing salon in figure 8.4.
Summary

- Strategies are a series of actions undertaken to achieve specific goals.
- The four key business functions include:
  - operations
  - marketing
  - finance
  - human resources.
- The key business functions are interdependent — each relies on the other to perform effectively.
- All business functions should:
  - work towards the fulfilment of the business’s goals
  - be coordinated so that they have a common purpose.
- In large businesses the key business functions are often separated into divisions or departments.
- In small businesses the key business functions are not separated but often overlap.
Revision
1 Define the term ‘strategies’.
2 Recall the focus of the strategies developed by management.
3 Identify the four key business functions.
4 Examine figure 8.2 on page 195. Recall two activities involved in each of the four key business functions.
5 Clarify why in small businesses the key business functions are sometimes outsourced.
6 Recount what occurs when there is interdependence between the key business functions.
7 Explain why in large businesses the key business functions are often separated into different divisions or departments.
8 Demonstrate what is meant by the overlapping of key business functions.
9 Propose why the key business functions need to be coordinated in a business that has separate divisions.

Extension
1 Determine why it is impractical to expect small businesses to have distinct functional areas.
2 Predict what will happen to a business whose key business functions are not united in trying to achieve the business’s overall intention.

8.3 Operations
Operations refers to the business processes that involve transformation or, more generally, ‘production’. It is a term that applies both to the manufacturing and the services sector. As explained in section 8.1, all businesses establish a set of goals. Next, the business implements strategies to achieve these goals. The core goal of all businesses is to maximise profits. This is often best achieved through the efficient production of a good or service. Operations management is the strategy used to achieve this goal. The HSC course investigates operations in greater depth, so this chapter will provide an elementary understanding of the main concepts.

Operations management consists of all the activities in which managers engage to produce a good or service. It is concerned with creating, operating and controlling a transformational process that takes inputs from a variety of resources, and produces outputs of goods and services that are needed by customers. When you buy a loaf of bread from the supermarket, for example, the bakery will have undertaken a number of processes from buying the ingredients, to mixing and blending them, baking, cooling then wrapping the finished loaves and, finally, delivering the loaves to the retail outlets.

BizWORD
Operations refers to the business processes that involve transformation or, more generally, ‘production’. Operations management consists of all the activities in which managers engage to produce a good or service.

FIGURE 8.5 Apple recently invested $10.5 billion in technology, meaning that even more of their manufacturing processes will be accomplished by machines and robots. The new technology includes equipment to polish the plastic cases of iPhones, laser and milling machines to carve the MacBook’s aluminium body and testing gear for their camera lenses.
Operations management, therefore, is at the heart of the success of all businesses. Production involves the skilful bringing together of a number of resources, such as finance, equipment, management, technology and people, to create finished goods and services through a series of operations (see the following Snapshot).

**Toyota — operations system**

Operations is the part of the business that ‘gets the job done’ and at Toyota’s manufacturing plant in Altona, Victoria that means producing over 100,000 cars each year, more than half of which are exported. The process of producing the Camry is much the same as producing a cake (or any other product for that matter). You need inputs (resources used in the production process, such as labour and raw materials). The next step is to transform those raw materials into outputs (finished products). Many of the components used to build an engine, such as pistons and cylinder head covers, are produced in-house by Toyota and some parts are sourced from local suppliers. What else is needed to make a car? Lots of steel panels that are welded and painted and undergo a multitude of processes to then finally reach the 250-metre long assembly line.

Operations is not just about making products or producing services though. Many businesses strive to produce the best product or service on the market. Toyota uses the concept of continuous improvement to do this (referred to in Japanese as kaizen). This means that all company activities — from the assembly line to customer service — are continually scrutinised, then new and better ways of doing things are introduced if needed. The Toyota process requires that all tasks are precisely defined and standardised to ensure maximum quality, minimum wastage and improved efficiency. Kaizen emphasises quality assurance and ensures that all employees are quality conscious and focused on continual improvement.

Just-in-time (JIT) production is also used at Toyota. This means that the right parts and materials are manufactured and provided in the exact amount they are needed, and at the time they are needed. The number of cars produced is directly related to customer demand. In relation to supply chain management, JIT ensures that only the required materials for production are acquired at the right time, which minimises excessive inventory and leads to cost reductions.

Technology is used at Toyota to advantage. For example, the welding involved to make the shell of a car involves 250 processes and 526 parts. Robots do 105 of the welding jobs and the remainder are done by workers on night and day shift. Toyota says they are automated but ‘with a human touch’.

**Snapshot questions**

1. Clarify why operations is referred to as that part of the business that ‘gets the job done’.
2. Outline the process of producing the Camry at Toyota’s manufacturing plant in Altona.
3. Define the term ‘kaizen’.
4. State how Toyota implements the concept of continuous improvement.
5. Explain the just-in-time (JIT) production method.
6. Determine the advantages Toyota gains by using the ‘kaizen’ and ‘just-in-time’ processes.

The nature and type of operations vary considerably from one type of good or service to another. However, how the operations management function is carried out will directly affect a business’s competitive position because it will:

- establish the level of quality of the good or service
- influence the overall cost of production, given that the operations function is responsible for the largest part of a business’s capital and human expenses
- determine whether sufficient products are available to satisfy consumer demand.
FIGURE 8.6 The operations manager is part of the senior management team and in a large business will most likely have many managers underneath him or her, such as the production manager, warehouse manager and quality manager.

The operations management function has a considerable influence on the quality, cost and availability of a business's goods or services. These, in turn, have a direct bearing on whether the business achieves its other main goals — specifically, to maximise profits, to increase market share, to maximise growth or to provide a reasonable return for investors.

**Goods and/or services**

A manufacturer will transform inputs into goods: tangible products. **Tangibles** are physical products that can be handled and stored before they are sold to the consumer, such as bread, clothing or a car. The production process and consumption are not linked; that is, there is little customer involvement in production.

A service organisation will transform inputs into services. Services are **intangible**, which means that they cannot be touched. For example, if you attend a training course, you cannot physically touch it, but you hopefully benefit from gaining knowledge and learning new skills. Services cannot be stored and the customer may actually need to be present when the service is being delivered. For example, the customer must be present when receiving a haircut.

In reality, many businesses today produce a combination of both manufactured goods and services. When you purchase a product such as a car or electronic equipment it often comes with a warranty and other services. When a customer enters a contract with an internet provider, for example, they will receive a service (their broadband connection), plus the modem and other goods necessary to enable the connection.

**Summary**

- Operations management is about producing goods and/or services based on business goals.
- The operations management function has considerable influence on the quality, cost and availability of a business's goods and/or services.
- Operations management is responsible for transforming inputs into outputs.
• The characteristics of operations management differ according to whether the business is a manufacturer of goods or a provider of services. Manufacturers produce tangible products (physical), while service organisations produce intangible products (services).
• Most modern businesses produce a combination of both manufactured goods and services.

Revision

1 Define the terms ‘operations’ and ‘operations management’.
2 State what operations management is concerned with.
3 ‘Operations management is the part of the business that actually gets the job done.’ Demonstrate this concept on a smaller scale by describing the materials you would need and the process you would undertake to bake a cake (your finished product).
4 Recall how the operations management function will directly affect a business’s competitive advantage.
5 Distinguish between a good and a service.
6 Account for why modern large businesses combine goods and services.

Extension

1 One strategy to produce goods more quickly is to use better technology. For example, if you used a hand beater to bake a cake it may not have been as efficient as using an electric beater. Fill in the following table and determine some strategies that an operations manager might use to achieve the listed business goals. The first entry has been completed for you.

<table>
<thead>
<tr>
<th>Business goal</th>
<th>Operations management strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improve the quality of service provided</td>
<td>Introduce quality management</td>
</tr>
<tr>
<td>Improve the quality of the product</td>
<td></td>
</tr>
<tr>
<td>Reduce production costs</td>
<td></td>
</tr>
<tr>
<td>Contribute to the protection of the natural environment</td>
<td></td>
</tr>
<tr>
<td>Increase profitability</td>
<td></td>
</tr>
<tr>
<td>Increase market share</td>
<td></td>
</tr>
</tbody>
</table>

2 Use the internet or look at the careers section of the newspaper to find a job advertisement for an operations manager (sometimes called a factory manager). The advertisement will most probably list responsibilities involved in the position. Classify these into the four management roles (planning, organising, leading and controlling).
3 Anita’s Cosmetic and Beauty therapy is a business specialising in a range of cosmetic and beauty enhancement treatments and products. Determine the range of operations activities offered in such a business.
4 Demonstrate how an operations manager of a manufacturing plant that produces confectionery might use the roles of planning, organising, leading and controlling in his or her daily job.

The production process

There are three key elements of the production process in any business: inputs, processes and outputs.
Inputs

Inputs are the resources used in the transformation (production) process. Some resources are already owned by the business, while others come from suppliers. Inputs differ between manufacturing businesses and service businesses. Inputs may be divided into those that are transformed and those that are transforming resources.

Transformed resources are those inputs that are changed or converted in the operations process; they are transformed by the operations process. Transformed resources include:

- **materials**: the basic elements used in the production process.
- **information**: the knowledge gained from research, investigation and instruction, which results in an increased understanding.
- **customers**: customers become transformed resources when their choices shape inputs.

Transforming resources are those inputs that carry out the transformation process. They enable the change and value adding to occur. The two main transforming resources are:

- **human resources**: the people that are employed by the business.
- **facilities**: the plant (factory or office) and machinery used in the operations process.

Transformation processes

The main concept of operations management is transformation, which is the conversion of inputs (resources) into outputs (goods or services). Sony, for example, takes plastic, metal, glass and electronic parts, and transforms them into numerous electronic products using an innovative approach and processes of design, manufacturing and assembly. Figure 8.8 illustrates this transformation process.

The term ‘transformation’ implies physical changes, but today it also includes the conversion of resources into services. Your school takes its main inputs — the students, the syllabus, the teaching and ancillary staff, and the buildings and other capital — and produces educated, employable graduates. What occurs in

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**BizWORD**

Inputs are the resources used in the transformation (production) process.

Transformed resources are those inputs that are changed or converted in the operations process.

Transforming resources are those inputs that carry out the transformation process.

**BizWORD**

Transformation is the conversion of inputs (resources) into outputs (goods or services).
this educational setting is a transformation process. It is the task of the operations manager to create, operate and control the transformation process, and table 8.1 illustrates how this happens in a number of different businesses.

**Figure 8.8** The transformation process in a clothing factory and a private hospital

**Table 8.1** The transformation process in a manufacturing and service business

<table>
<thead>
<tr>
<th>Inputs supplied by existing resources or external supplier</th>
<th>Transformation process</th>
<th>Outputs — either goods or services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clothing factory&lt;br&gt;Pattern cutters, designers, drivers, machine operators, material, sewing machines, labourers</td>
<td>Computer-based designing, dyeing, hand and machine cutting, machining, branding, manual random checking</td>
<td>Dresses, shirts, suits, trousers etc.</td>
</tr>
<tr>
<td>Private hospital&lt;br&gt;Nurses, doctors, operating theatre, computers, beds, drugs, laboratory, X-ray facilities</td>
<td>Consultation, diagnosis, assessment of alternatives, treatment (referral to specialist or done by a general practitioner, GP)</td>
<td>Patient returned to health</td>
</tr>
</tbody>
</table>

Owing to the vastly differing nature of business, the transformation process varies from business to business. It is often useful to look at the transformation process in a manufacturing business separately from the process in a service-based business because the transformation processes in manufacturing are far more visible and more easily quantified.

**Transformation process in manufacturing businesses**

The manufacturing process may involve different kinds of processing. One type takes the most basic resources and transforms them into the final goods for the use of consumers. Other types involve a step-like transformation across a range of processors and businesses.
Transformation process in service businesses
Due to the intangible nature of services, the operations processes are less physical or visible. They take the form of knowledge, inputs, expertise and so on (see figure 8.11).

FIGURE 8.9 Operations in the manufacturing process

FIGURE 8.10 An operations system for a manufacturing company producing building products

BizFACT
As a result of the intangible nature of services, the operations processes are less physical or visible.

FIGURE 8.11 Operations in service businesses
Transformation processes adopted by service businesses differ from those in manufacturing businesses for two reasons:

1. Outputs of the service business cannot be physically held in stock. A bank, for example, cannot perform transactions on behalf of customers in advance and store these in anticipation of use at a future date.

2. Service businesses rely heavily on interaction with the customer in determining the output. Before an output is generated, the bank, in the example, needs the customer to indicate whether he or she requires a car loan, a deposit, a withdrawal or any other particular service.

**Table 8.2** Highlighting the difference between manufacturing and service operations

<table>
<thead>
<tr>
<th>Manufacturing operations</th>
<th>Service operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tangible items are produced — they may be customised, but generally they are standardised and often mass produced.</td>
<td>Intangible and customised, or made to suit the individual's requirements</td>
</tr>
<tr>
<td>Generally located close to supplies of raw materials or inputs (transport costs are of major concern)</td>
<td>Must be close to markets — location and proximity to users of services is vital</td>
</tr>
<tr>
<td>Zoning determines actual siting.</td>
<td>Zoning may allow for home-based flexibility.</td>
</tr>
<tr>
<td>High capital costs in operations but can achieve some economies of scale</td>
<td>High training/education costs but can operate with low capital costs</td>
</tr>
<tr>
<td>Employs unskilled or technically skilled people, so average cost of labour/workforce is low.</td>
<td>Focus is on skilled/experienced/semi-skilled and professional staff, so labour costs are relatively higher.</td>
</tr>
<tr>
<td>Quality of output is standardised and backed by warranty.</td>
<td>Quality varies depending on the strength of industry regulations, skill, experience, knowledge and honesty of practitioner. Backed by public liability insurance. Customer or client relations are ‘everything’.</td>
</tr>
<tr>
<td>Uses manufacturing technology</td>
<td>Uses office automation</td>
</tr>
<tr>
<td>Manufacturer generally makes the product and then awaits sale (thereby risking unsold stock).</td>
<td>The server only acts once the demand for a service is identified — hence less risk.</td>
</tr>
<tr>
<td>The goods last beyond the time over which they are paid for — they tend to be durable.</td>
<td>Services by their nature are inherently non-durable, though the actual work done may have lasting effects.</td>
</tr>
</tbody>
</table>
Outputs

Essentially, outputs refer to the end result of a business’s efforts — the good or service that is delivered or provided to the consumer (see figure 8.13). So far, a distinction has been drawn between service and manufacturing operations, but in many cases businesses carry out both types of operation. Toyota, for example, separates its vehicle manufacturing operation from its customer service operation, although both elements are critical to the business’s overall success. All businesses carry out many activities that can be isolated from direct involvement with the customer. Insurance companies employ mathematicians called actuaries who use formulas to determine risk and probability in setting the level of insurance premiums. Actuaries never deal directly with the public, but are instrumental in forming parameters or boundaries in which operations will occur.

The operations manager must be able to link transformation processes to the activities performed by other areas of the business. Output must always be responsive to customer demands. Issues of quality, efficiency and flexibility must be balanced against the resources and strategic plan of the business.

Summary

• The three key elements of the production process include inputs, the transformation process and outputs.
• Inputs are resources used in the production process and include raw materials, capital equipment, labour, information, time and money.
• The transformation process is the conversion of inputs into outputs.
  – Transformation processes in manufacturing businesses are different to those of service-based businesses.
• Outputs are the finished goods or services.
Revision
1 Identify the three key elements of the production process.
2 Distinguish between the two types of inputs.
3 ‘The main concept of operations management is transformation’. With reference to an example, clarify the meaning of this statement.
4 State why the transformation processes adopted by service businesses differ from those in manufacturing businesses.
5 Using the process of completing homework, for example, construct a diagram that describes the operations component (that is, the transformation from no homework done to all homework completed).
6 Identify the inputs, processes and outputs of the following businesses:
(a) Hilton Hotel
(b) Four ‘n’ Twenty pies.
Present your answer in table form, as shown in table 8.1 on page 203.
7 Distinguish between ‘input’, ‘transformation’ and ‘output’.
8 The Rio Tinto Group is an international mining company. Rio Tinto finds, mines and processes mineral resources, which are then converted to products such as coal, copper, gold and silver. Use the Rio Tinto weblink in your eBookPLUS to identify the inputs, transformation processes and outputs that Rio Tinto use to produce its products.
9 Discuss the main differences between the operations function in a manufacturing business and a service-based business.

Extension
1 Use the Biz/ed weblink in your eBookPLUS to find the Virtual Factory link (click on Virtual Worlds). Go to ‘Factory floor’ and then to ‘Production’. Complete the following tasks.
(a) State the stages of production involved in the manufacturing of hot-air balloons.
(b) Identify the inputs, processes and outputs of the balloon factory.
(c) Determine what type of layout is used at the Cameron Balloons plant. Give reasons for your answer. (Hint: Examine fixed position layout, product layout, process layout.)
(d) Extrapolate why this type of layout would have been chosen.
(e) Propose whether the production of balloons is capital intensive or labour intensive. Give reasons for your answer.
2 Contact a manufacturing business and survey its response to a range of questions that you, or a small group, have written and emailed regarding the operations function in their business. Synthesise your findings and present them to the class.
3 Contact a service-based business and survey its response to a range of questions that you, or a small group, have written and emailed regarding the operations function in their business. Synthesise your findings and present them to the class.

Quality management
Quality management is the strategy which a business uses to make sure that its product meets customer expectations. Three quality approaches are quality control, quality assurance and total quality management.

Quality is very important to Tip Top Bakeries, the bakery division of George Weston Foods Limited. To Tip Top, quality means understanding and exceeding customer expectations and making sure that products comply with regulations. A quality product should have a high degree of excellence and should achieve its stated purpose. A quality product should be reliable, easy to use, durable, well designed, delivered on time, include after-sales services, and have an agreeable appearance.
FIGURE 8.14 Quality is very important to Cafe2U. The Australian mobile coffee franchise operates quality equipment and uses quality ingredients in its branded products. Cafe2U is so passionate about coffee that it has won several national and local awards, including a bronze medal in the 2010 CSR Golden Bean Roasting Competition. Cafe2U is accredited for Safe Food Handling and meets the standards of the Franchise Council of Australia.

The benefits of quality management practices
The benefits of implementing quality management practices include:

- reduced waste and defects
- reduced variance in final output
- strengthened competitive position
- improved reputation and customer satisfaction
- reduced costs
- increased productivity and profits.

Operations managers use a variety of approaches to maintain or improve quality. Tip Top uses quality control and quality assurance. Many businesses use an approach called total quality management.

Quality control
Tip Top bakeries uses quality control to optimise its production process. Quality control reduces problems and defects in the product using inspections at various points in the production process. Many businesses such as Tip Top have minimised errors and waste by ensuring that standards are met. Specifications or benchmarks are set before the physical checks are completed. Actual performance is then compared to the established criteria. If the established standards are met, it is likely that the business will be meeting customer expectations. Competitiveness increases as the costs associated with waste and faulty products are reduced.

In a service business, an inspection of employee performance can be used as a means of quality control. A bank might inspect teller accuracy, speed or courtesy. In a call centre calls might be monitored for quality assurance and control purposes.
Quality assurance

Quality assurance involves the use of a system so that a business achieves set standards in production. This is a proactive approach to quality management that aims to prevent defects or problems from occurring.

Quality assurance is an integral part of Tip Top’s operations. A quality system is in place to ensure that set standards are achieved. Tip Top’s quality systems are certified to the ISO 9002 standard. The ISO 9000 series of quality certifications is a widely used international standard. ‘ISO’ stands for International Organization for Standardisation. Meeting these international standards is voluntary, but many businesses comply with their requirements to remain competitive locally and internationally. The ISO provides guidelines on how businesses should establish quality assurance systems by adopting specific procedures, controls, and recording and documentation measures. Tip Top’s quality system gives assurance to customers that it is able to provide safe and reliable products.

Total quality management

Total quality management (TQM) is a commitment to excellence that emphasises continuous improvement in all aspects of a business’s operation by sharing responsibility among all the members of the business. Quality becomes both a commitment and the responsibility of every employee in the business. The aim of TQM is to create a defect-free production process, and maintain a customer focus in operations. The adoption of TQM can improve the price competitiveness of a business, but can also improve product quality, allowing the business to attain competitive advantage. To achieve TQM objectives a number of approaches may be used, such as employee empowerment, continuous improvement and improved customer focus.
Ambulance Victoria — quality first

Quality is very important to Ambulance Victoria (AV). As an organisation that provides medical transport and pre-hospital care for patients, any mistakes or faults in its service can be life-threatening.

AV uses quality control to optimise its production process. Quality control reduces problems and defects in the product, using inspections at various points in the production process. As a service organisation, AV monitors quality and response times. AV is involved in the Victorian Cardiac Arrest Registry (VACAR) — a quality control initiative. It uses a cardiac arrest registry to collect data on cardiac arrest patients who have used its ambulance service. This data is then used to monitor treatment protocols, response intervals and outcomes on cardiac arrest patients.

Quality assurance is an integral part of Ambulance Victoria’s operations. A quality system is in place to ensure that set standards are achieved. AV’s quality systems are certified to the ISO 9001:2000 standard. Ambulance Victoria’s quality system gives assurance to customers that it is able to provide safe and reliable service.

AV also has ongoing involvement in two quality assurance registries: Turning Point Drug and Alcohol Centre — Non Fatal Overdose Registry and the Victorian State Trauma Outcomes Registry (VSTORM). In addition, three AV Research Fellows are involved in clinical research in three high priority areas: out-of-hospital cardiac arrest, trauma and stroke.

AV developed an AV quality management system. A quality committee was established in order to monitor the implementation and effectiveness of this system and to promote the development of a business-wide culture to achieve the management of quality improvement. This committee also has the responsibility of developing policies and guidelines on clinical care and paramedic training.

Snapshot questions

2. Explain how Ambulance Victoria benefits from adopting these strategies.

Employee empowerment

W. Edwards Deming was an American quality expert who was known as the ‘founder of the quality movement’ and is credited with the development of TQM. Deming believed that quality problems would be best solved with an emphasis on employee involvement. Many businesses use quality circles as a means of achieving employee empowerment. Under this approach, teams of up to 10 workers meet regularly to solve problems related to process, design or quality. The groups often make presentations to management with their ideas, in order to improve the performance of the business. Such programs have resulted in substantial cost

BizWORD

Quality circles are groups of workers who meet to solve problems relating to quality.
savings for organisations — for example, at the Northrop Aircraft division that produces Boeing 747s, 55 individual quality circles halved the cost of parts within two years. At Chrysler, a quality circle discovered that heating rubber seals before installation could prevent car door leaks.

Continuous improvement
Continuous improvement is a process that involves a constant evaluation of, and improvement in, the way things are done. Higher and higher standards are set in the continual pursuit of improvement. Kaizen (Japanese for ‘improvement’) emphasises continuous improvement in all facets of a business, from the way the CEO manages to the way assembly line workers perform their jobs. Although perfection is practically impossible to achieve, it is the ‘striving’ that is important to business culture.

Customer focus
Deming believed that quality should be the responsibility of every employee. The TQM approach considers one of the most important questions a business should ask: ‘What does the customer require?’ All teams need to realise that they are serving a customer. This is as true for the employees that deal directly with external customers as for those that simply pass work on to other employees inside the business.

Summary
- Quality management is the strategy that a business uses to make sure that its product meets customer expectations. Three quality approaches are quality control, quality assurance and total quality management.
- Quality control involves the use of inspections at various points in the production process to check for problems and defects. Performance is measured in relation to set standards or benchmarks.
Quality assurance involves the use of a system where a business achieves set standards in production. This is a proactive approach to quality management that aims to prevent problems from occurring.

Total quality management (TQM) is an ongoing, business-wide commitment to excellence that is applied to every aspect of the business's operation. A number of approaches may be used, such as employee empowerment, continuous improvement and improved customer focus.

Revision

1 Outline the main features of quality management.
2 Explain why quality control is important to businesses.
3 Describe the ways a business can offer quality assurance to customers.
4 Explain what is meant by total quality management.
5 Summarise the three approaches that make up total quality management.
6 Read the following definitions. If a definition is false, propose a correct definition.
   (a) Quality control involves the use of inspections at various points in the production process.
   (b) Quality assurance involves the use of a system where a business achieves set standards in production.
   (c) Total quality management is a commitment to quality that is applied to the business's operations department.
   (d) Continuous improvement involves an ongoing commitment to use of inspections.
7 Ganesh is the production manager for IBX technology, a manufacturer of internet security software. Recently, the level of product defects has increased, although the production process has not changed.
   (a) Propose to Ganesh strategies that he should use to determine the cause(s) of the defects.
   (b) Explain to Ganesh the value of introducing a TQM approach.
8 The name ‘The Reject Shop’ suggests that it could not possibly sell quality products. Is this true? Use the weblink for The Reject Shop in your eBookPLUS to search the company’s website and see how many references to quality you can find. Explain how The Reject Shop ensures that it receives quality products from suppliers.

Extension

1 Use the Standards Australia weblink in your eBookPLUS to obtain information about Australian Standards. Assess the practical effects of such standards on industry.
2 Investigate W Edward Deming and his development of TQM. Justify whether you think he proposed anything extraordinary or he just made businesses more aware of their production methods.

8.4 Marketing

Marketing is vital to the existence of the business. Just because someone invents a new product or improves an existing one does not guarantee customers will buy it. Without some form of marketing, customers may not even be aware of a product’s existence regardless of how ‘record breaking’, ‘new and improved’ or ‘revolutionary’ it may be (see the following Snapshot). Statistics reveal that more than 70 per cent of new products launched on the market self-destruct in the first year of operation, mainly because of poor marketing. Businesses make few sales if they do not market their products successfully, eventually ending in failure.
Edward Evans’s SaferGate — the value of marketing

Did you ever watch the ABC television show called The New Inventors? The show presented the inventions of men and women and demonstrated how these inventions could make someone’s life a little easier, safer or better.

Edward Evans was seriously injured in a farm gate accident on his property when an 1100 kg cow charged a gate as he was moving cattle, sandwiching him between the gate and beast. To minimise the risk of further injury on his own farm, he invented a method of gate operation. After hearing about thousands of other injuries and tragic deaths that occur each year as a result of cattle handling operations, Evans was inspired to improve his design and provide the opportunity for increased safety in cattle yards around the country.

The result is SaferGate, a safer gate that has been designed to minimise the risk of injury when livestock charge or attack a gate. The gate is rock solid and has a hinge that allows the gate to fold in the middle if an animal charges at it, to avoid gate operators from being hit by the full force of the impact even if they are standing right behind it. Unlike a traditional cattle gate, it swings away from the farmer when an animal hits it. The design was so innovative, that it won Evans the ABC New Inventors 2011 Invention of the Year award.

As is the case for most contestants, that program was the first time Evans’ product was exposed and critically examined, rated and promoted in the public arena. The objective is not only to win the contest, but to gain support to manufacture, promote and distribute the invention to domestic and overseas markets. Evans also received a $45 760 grant from Commercialisation Australia which he used to ensure the intellectual property was protected, to begin manufacturing and to develop marketing strategies.

A great invention like Edward Evans’s SaferGate is of little value, however, if it has not been effectively marketed — brought to the attention of the general public and targeted towards those who would be most interested in putting it to use.

**Snapshot question**

*Explain why Edward Evans must quickly develop a marketing plan for his SaferGate invention.*

At the same time, many products that would seem insignificant and unimportant have become best-selling ‘essential’ items as a result of a well-managed and professional marketing plan. Who would have ever thought that brown, sugary, fizzy water with addictive qualities would become the universal product it is today!

Marketing is a powerful business strategy available to all businesses. The HSC course investigates marketing in greater depth, so this chapter will provide an elementary understanding of the main concepts.

**Marketing fundamentals**

Marketing is not a new subject to you. Over the years you have probably been involved in some type of marketing activity. Consider the following examples:

- helping to organise a stall at a local fete
- setting up a raffle for a local sporting team
- persuading your parents to lend you some money to buy an iPod
- coordinating the publicity for the school musical.

Although all these activities are different, they have one thing in common: they involve a number of marketing activities. Some people may think that marketing...
is just a fancy name for selling, but there is much more involved than selling. Actually, the current view of marketing is such that it does not even have to involve the selling of a product — for example, not-for-profit organisations may want to inform the public of the services they provide.

![Advertising](image)

**FIGURE 8.18** Advertising is one of the main forms of promotion used to inform, persuade and remind. Guy Sebastian supports the Australian Red Cross. Popular public figures often support good causes in media campaigns.

**What is marketing?**

Many definitions are used to describe marketing. The most commonly accepted definition comes from the American Marketing Association: ‘Marketing is the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organisational objectives’.

A more simplified definition is that marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers. At the heart of these activities is the most fundamental question all businesses should continually ask: ‘What do customers want to buy — now and in the future?’ This is the essence of marketing — finding out what the customers want then attempting to satisfy their needs.

Sometimes ‘selling’ and ‘marketing’ are used synonymously. However, the two words have different meanings. Selling is merely getting rid of existing stock, whereas marketing takes a much broader view. Successful marketing involves bringing the buyer and seller together and making a sale.

Some small business owners are excellent ‘technicians’ but dislike marketing and inadvertently turn away customers. Other small business owners are so convinced of the value of the good or service that they assume it will sell automatically. Unfortunately, this rarely occurs.

Many small business owners feel marketing is not for them. They happily place advertisements in local newspapers, display the name of the business on their cars.
and perhaps even advertise on a regional radio or television station. However, such advertising is just one part of marketing a good or service.

Small business owners often view marketing campaigns as something only large businesses do, and as too expensive, complicated or time consuming for themselves. What they do not often appreciate is that they can run a marketing campaign and that it can be simple and inexpensive.

All businesses, regardless of size, need to undertake some form of marketing, otherwise customers will not be informed about the business’s products.

Quick-fire Clay — marketing a new product

Michelle Giles had never lost faith in the idea. Three years of hard work was about to be rewarded. By the end of the day, the patent application would be finalised, giving her sole rights to her invention, Quick-fire Clay.

As a potter, Michelle had always been conscious of the high cost of operating the kiln. She had tried alternative energy sources, but the best she could manage was to reduce the energy bill to 38 per cent of total costs. She decided to think a little more creatively — if she could not further reduce the energy costs, then perhaps she could reduce the time the clay needed to be in the kiln. Inventing a clay that required only half as much firing time would reduce her operating costs.

After spending three years in experimentation and mortgaging her house to help pay for research and development, Michelle was about to make Quick-fire Clay her exclusive product. She had managed to develop a clay-based material that required only half the normal firing time. Another unexpected benefit was that the material became less fragile and did not shatter when dropped. Michelle knew she had a product that would be in great demand and make her a lot of money. Not wanting to lose the right to her invention, she decided to apply for a patent. She left the Patents Office feeling optimistic about the future and enjoyed a celebratory meal at a nice restaurant. She believed her product to be a great success.

Michelle failed to realise, however, that while the first stage — developing a new product — was complete, the second stage was just about to begin — the successful marketing of her product. Although she had a world-first, proven product, very few people knew about it. Michelle was about to discover that products do not ‘sell themselves’. Without customers, a product — even one that is revolutionary, efficient, record-breaking and exciting — is useless. Many inventors like Michelle have failed, even though they had an excellent product. They lacked customers and no customers means no profit. Michelle had a lot to learn about successfully marketing her product.

Snapshot questions

1. A patent is a government approved document that gives a person sole rights to their invention and stops others from using, copying or selling it without permission. Outline why you think Michelle was wise to patent Quick-fire Clay.
2. Recommend marketing strategies for this business.
Role of marketing
Marketing is much more than placing an advertisement in the local media. It is a way of thinking. Everything a business does should be directed towards putting the customer at the centre of its thinking. To do this successfully requires adopting a customer-oriented approach to marketing. Business owners need to view their business in terms of the needs and wants of their customers (see figure 8.19). As competition intensifies, it will be their marketing philosophy that will help their business face the competition and succeed.

1. Place your customers, not your products, at the centre of all you do.
2. Talk to your customers. Ask them what could be improved, what they like and dislike.
3. Think about ways to build loyalty with your customers.
4. Differentiate your product in ways that will make it special in the eyes of your customers.
5. Regularly communicate with your present and potential customers.
6. Develop a unique and recognisable brand or image that reflects the special qualities of your business.
7. Always deliver what you promise.

FIGURE 8.19 Seven tips to becoming a marketing driven customer-oriented business

For businesses that adopt a customer-oriented approach, the customer relationship does not end with the sale; it begins there. These businesses will continuously strive to not simply meet but exceed customer expectations. This means that, at every level of the business, employees should work towards customer satisfaction by establishing positive relationships with customers. To do this successfully a business should adopt the marketing concept approach.

Summary
• For a business to make a profit, it needs to create and market products that consumers will purchase.
• Marketing is a total system of interacting activities designed to plan, price, promote and distribute products to present and potential customers.
• Successful marketing involves bringing the buyer and seller together and making a sale.
• Businesses should continuously strive to not simply meet but exceed customer expectations.

Revision
1. Outline the importance of marketing to a business.
2. Recall why most new products fail shortly after they are launched.
3 Identify some types of marketing activities you have been involved in.
4 Discuss how the ‘marketing’ definition provided in this chapter differs from your previous understanding of the term.
5 Distinguish between selling and marketing.
6 Recall why all businesses, regardless of size, need to undertake some form of marketing.
7 Justify why a business should adopt a customer-oriented approach to marketing.
8 Refer to figure 8.19 on page 216. Identify which of the ‘seven tips’ you think is the most important. Justify your answer and share it with other class members.
9 Recall the correct response to complete the following sentences.
   (a) The main emphasis in marketing today is the ________-oriented approach.
   (b) This means the business wants to ________ customers’ needs and wants rather than merely produce products.

Extension

1 Construct a PowerPoint presentation containing 10 dot points that reflect key features of your new understanding of marketing.
2 ‘Marketing is not the sole responsibility of the marketing manager, but all managers.’
   Determine the accuracy of this statement.
3 Predict what will happen to a business that neglects the importance of marketing.

Identification of the target market

Very few businesses can afford to market their products to all consumers or all businesses in Australia. At the same time, few businesses would want to because it is a very rare product that is suitable to all consumers. Until the end of the 1950s, Coca-Cola was such a product. But today Coca-Cola offers consumers a range of carbonated soft drinks based on its original cola formula including Coca-Cola Zero, Diet Coke and Vanilla Coke, as well as non-cola drinks such as Pump still water, PowerAde Isotonic and Goulburn Valley juices. Most businesses must select specific groups of customers on which to concentrate their marketing efforts: their target markets. A target market is a group of customers with similar characteristics who presently, or who may in the future, purchase the product.

Three broad approaches can be adopted when selecting a target market: the mass marketing approach, the market segmentation approach or the niche market approach (see figure 8.20).

**BizWORD**

A target market is a group of customers with similar characteristics who presently, or who may in the future, purchase the product.
Mass marketing approach

Fifty years ago, marketers commonly spoke about ‘mass market’. In other words, there was a large demand for a standard product. In a mass market, the seller mass-produces, mass-distributes and mass-promotes one product to all buyers. The Model T Ford, for example, was the first motor vehicle to be produced and sold to the mass market (see figure 8.21).

A mass marketing approach seeks a large range of customers. The business develops a single marketing mix and directs it at the entire market for the product. This means there is one type of product with little or no variation, one promotional program aimed at everyone, one price, and one distribution system used to reach all customers.

Few products today, apart from basic food items, water, gas and electricity, are marketed to the mass market. As a result of greater choice, higher personal incomes and customers seeking more individualised products, the mass market has been replaced by segmented or niche markets.

Market segmentation approach

Few businesses can sell their products to the entire market — the market is just too big. Therefore, a business will divide the market into distinct segments. A business that is marketing motor vehicles, for example, would not direct its marketing efforts towards every person in the total vehicle market. Some people might want only a sports car; others might want a four-wheel drive. The business would thus direct its efforts towards a particular segment of the total market for motor vehicles.

Market segmentation occurs when the total market is subdivided into groups of people who share one or more characteristics based on four elements or dimensions: demographic, geographic, psychographic and behavioural, as shown in table 8.3.
A business segments its market so it can better direct its marketing strategies to specific groups of customers, rather than the mass market. The ultimate aim of market segmentation is to increase sales and profits by better understanding and responding to the desires of the target customers.

Once the market has been segmented, the business selects one of these segments to become the target market (see figure 8.22). For example, a rural supplies business would normally aim its promotion strategies at male, 25 to 60-year-old, rural-based farmers with middle to high incomes. An exclusive women’s fashion boutique in central Sydney would have a target market of customers who are female, 25 to 45-year-old, city-based professionals with high incomes.

This approach allows the business to better satisfy the wants and needs of a targeted group, because the business can:

- use its marketing resources more efficiently
- better understand the consumer buying behaviour of the target market
- collect data more effectively and make comparisons within the target market over time
- refine marketing strategies used to influence consumer choice.

### BizWORD

**Consumer buying behaviour** refers to the decisions and actions of consumers when they purchase goods and services for personal household use.
Sometimes, a business may be able to identify both a **primary** and **secondary target market**. Customer research conducted by Sportsgirl Fashion, for example, revealed a primary target market of 18 to 25-year-old females, as well as a secondary target market of 26 to 40-year-old females. The ability to choose the correct target market is an important marketing function because it will influence the entire marketing plan (see the following Snapshot).

**Beau’s Floral Studio — target market**

Beau Wilkes is owner-operator of a retail florist store called Beau’s Floral Studio. The business provides fresh and dried flowers, and associated product lines for all occasions. The business markets to a wide cross-section of the population within the surrounding suburbs, but particularly to females aged 15–65 years and males aged 15–25 years.

**Size of target market**

- **Potential**
  Beau’s potential target market consists of approximately 74,000 people who live in the surrounding suburbs.
- **Actual**
  Beau’s primary target market consists of females aged 35–65 years who decorate their homes with floral displays.
  The two secondary markets consist of:
  - females aged 15–65 years who purchase flowers for special occasions
  - males aged 15–25 years who purchase flowers for their partners.
  These target markets are important because they represent repeat customers who are essential for the business’s long-term survival. The primary target market consists of approximately 21,000 people. It can be further subdivided according to the benefits sought by the customer, as shown by the following table.

**Subdivision of target market**

<table>
<thead>
<tr>
<th>Benefits sought by customer</th>
<th>Customer characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comfort (sickness and sympathy)</td>
<td>Male and female, aged 15 years and above</td>
</tr>
<tr>
<td>Beauty (floral displays)</td>
<td>Predominantly female, aged 35–65 years</td>
</tr>
<tr>
<td>Happiness (weddings and parties)</td>
<td>Predominantly female, aged 15–50 years</td>
</tr>
<tr>
<td>Affection</td>
<td>Predominantly male, aged 15–45 years</td>
</tr>
</tbody>
</table>

**Target market dimensions**

- **Geographic**
  Beau’s Floral Studio targets the residents of the local area. Sales to customers from outside the surrounding suburbs are only occasional, not regular, and do not constitute an important segment for the purposes of her marketing plan.
- **Demographic**
  Customer research data collected over the past 12 months reveal that 67 per cent of customers were female and 33 per cent were male. Females aged 35–65 years were the most common type of customer, making up 83 per cent of the total female customer base. Males aged 15–25 years made up 78 per cent of the total male customer base.
Purchase decision maker
Predominantly, the purchase of fresh and dried flower arrangements is considered to be a gift purchase, for either the individual or another person. The experience of a floral purchase should be considered within this context. A positive experience produces return business.

Income level
Beau’s Floral Studio caters for the middle to high income groups. These groups consist of individuals and households with high levels of disposable income. They do not perceive the buying of flowers as an infrequent luxury expenditure, but as a regular (weekly or fortnightly) purchase.

Snapshot questions
1. Identify the primary and secondary target markets for Beau’s Floral Studio.
2. Recall what four variables Beau Wilkes uses to segment the target markets.
3. Explain the importance of these target markets to Beau’s Floral Studio.
4. Analyse how segmenting the total market helps Beau Wilkes achieve her long-term business objectives.

Niche markets
An extension of the market segmentation approach is that of the niche market, which is a narrowly selected target market segment. In a sense, it is a segment within a segment, or a ‘micro market’ (see figure 8.23). For example, in any newsagency, you will see row upon row of magazines each appealing to a specific niche market — male, female, young, old, high-income, low-income, urban, rural, outdoor lifestyle, indoor lifestyle and so on.

BizWORD
A niche market is a narrowly selected target market segment.

Summary
• A target market refers to the group of customers to which a business intends to sell its product.
• Sometimes a business may be able to identify both a primary and a secondary target market.
Three broad approaches can be adopted when selecting a target market: the mass marketing approach, the market segmentation approach or the niche market approach.

- A mass marketing approach seeks a large range of customers.
- A business segments its market so it can better direct its marketing strategies to specific groups of customers.
- Market segmentation occurs when the total market is subdivided into groups of people who share one or more common characteristic.
- A niche market is a narrowly selected target market segment.

**Revision**

1. **Distinguish** between mass, segmented and niche markets.
2. **Outline** the purpose of market segmentation.
3. **Recall** the different ways a market may be segmented.
4. **State** why market segmentation is the most common marketing approach used by businesses today.
5. **Explain** how market segmentation and target market are linked.
6. Use an ‘M’, ‘S’ or ‘N’ to **determine** whether the following products are sold in a mass market, segmented market or niche market.
   - (a) Electricity
   - (b) Ferrari cars
   - (c) Australian Financial Review
   - (d) Avon cosmetics
   - (e) Fruit and vegetables
7. **Determine** who is most likely to be the target market for each of the following small businesses. (You may think of more than one market for some businesses.)
   - (a) Convenience store
   - (b) Mechanic
   - (c) Accountant
   - (d) Nursing home
   - (e) Childcare centre

**Extension**

1. ‘Any business that neglects the role of marketing will almost certainly experience low levels of sales and reduced profit levels.’ **Evaluate** the accuracy of this statement.
2. In small groups, conduct a survey of 30 people to **investigate** what type of movies they watch at the cinema. Using a database, group the respondents by age and sex. Present your results in the form of graphs and charts.
3. In small groups, **create** a customer survey form for obtaining information on a business’s level of service, product range, business facilities and suggestions for improvement. **Compare** each group’s survey.

**Marketing mix**

Once the business owner has established the marketing goals (a statement of what the business expects to achieve through the marketing activities) and selected a target market, the next step of the marketing plan is to develop marketing strategies to achieve the goals. **Marketing strategies** are actions undertaken to achieve the business’s marketing goals through the marketing mix.

One of the most useful ways of understanding how to develop a marketing strategy is to examine each of the elements of the marketing mix. The **marketing mix** refers to the combination of the four Ps — product, price, promotion and place (distribution). The business has control over these elements and uses them to reach its target market. As well, the business has control over other organisational resources — such as information, finances and employees — that may also be used to achieve marketing goals.
Once the four Ps have been established, the business must then determine the emphasis it will place on each of the variables. This will largely be determined by where the product is positioned or its stage in the *product life cycle*. For example, a product that is being marketed with an image of exclusivity and prestige will require a marketing mix totally different from a no-frills, generic item. A different marketing mix will also be required for a product in its introductory stage than when it reaches the decline stage.

**Product**

This element of the marketing mix involves much more than just deciding which product (goods or service) to market. The business owner needs to determine the product’s:

- quality
- design
- name
- warranty and guarantee.

The product is a combination of all these variables. Customers will buy products that not only satisfy their needs but also provide intangible benefits such as a feeling of security, prestige, satisfaction or influence.

**BizFACT**

A business may vary its marketing mix when it wants to reach different target markets.

**BizWORD**

The *product life cycle* describes the life of a product over four stages: introduction, growth, maturity and decline.

**Weblink**

Use The four Ps of marketing weblink in your eBookPLUS to discover more about the four Ps of marketing, and the strategy and implementation around these four elements.

**FIGURE 8.24 The four Ps of the marketing mix**
One intangible benefit of utmost importance is customer service. A product may be superior in all aspects compared with its rivals. However, if the manufacturer is unable to deliver a high degree of customer service to complement the product, it will soon fail in the marketplace. Some businesses spend large amounts of money establishing a brand name, but their brand name advantage is quickly lost if they do not also focus on their relationship with the customer. Such a relationship is usually built around the level of customer service offered.

Businesses should also remember that customer service does not end with the sale. Ongoing service, especially for complex and expensive products, is crucial to maintaining strong customer relationships. A business needs to undertake much careful planning about after-sales service when developing the product.

Product packaging

The packaging of a product is sometimes as important as the product itself to assist sales. Well-designed packaging will give a positive impression of the product and encourage first-time customers to purchase. Tasteful packaging can create an image of luxury, sensuality and exclusiveness, helping to promote the product. In addition, packaging helps preserve, inform, protect and promote the product.

With increasing community awareness of environmental pollution, businesses must also be sensitive to the problems caused by throw-away packaging. Approximately half of all household garbage consists of discarded packaging.

**FIGURE 8.26** It takes 2.6 seconds for a customer to choose one product instead of another, so the packaging has to be right. A Year 11 student from Melbourne High won a prize in the National Schools Packaging Design Challenge conducted by the Packaging Council of Australia. His cylinder biscuit container preserves, protects, informs and promotes with its classy labelling, including the mandatory labelling requirements. More details on this national challenge can be found at www.pca.org.au/education.

Product branding

An important part of the product development is the brand and associated brand logo. Combined, these can be a powerful marketing tool. For example, the three-pointed star of the Mercedes-Benz and Coca-Cola’s distinctive narrow-waisted bottle are famous brand names and symbols. Some businesses encourage the instant recognition of their brand symbol rather than their brand name. Perhaps the most famous example of this technique is the ‘golden arches’ symbol used by McDonalds. In some advertisements the brand name does not appear at all, only the brand symbol. This is a clever and subtle method used to reinforce the meaning of the symbol and associate it with a brand name.
Price

Many business owners have difficulty selecting the ‘correct’ price for their product. A price set too high could mean lost sales, unless superior customer service is offered. A price set too low may give customers the impression of a ‘cheap and nasty’ product. Therefore, correct pricing is important. Business owners normally choose one of three methods for calculating price.

1. **Cost-based**: a pricing method derived from calculating the total cost of producing or purchasing a product and then adding a mark-up for profit (see figure 8.27).
2. **Market-based**: a method of setting prices according to the interaction between the levels of supply and demand — whatever the market is prepared to pay.
3. **Competition-based**: choosing a price that is either below, equal to or above that of the competitors.

![FIGURE 8.27 Cost-based pricing is commonly used by large retail stores. The cost price is increased by a fixed percentage to arrive at the selling price. Assume a sporting goods store has a mark-up of 100 per cent. A tennis racquet is bought for $200 and, with a 100 per cent mark-up, will have a selling price of $400.]

Promotion

To sell more of its products, a business has to change customers’ behaviour through information or persuasion. This is achieved through promotion. The role of **promotion** is to inform, persuade and remind consumers about a business’s products, with the aim of:

- attracting new customers by raising awareness of a particular product
- increasing brand loyalty by reinforcing the image of the product
- encouraging existing customers to purchase more of the product.

Many people confuse promotion with advertising because of its visibility and frequency. However, advertising is just one of the four elements of the promotion mix. The main forms of promotion are as follows:

1. **Personal selling and relationship marketing**: personal selling involves the activities of a sales representative directed to a customer in an attempt to make a sale. Relationship marketing refers to the development of long-term, cost-effective and strong relationships with individual customers.
2. **Sales promotion**: refers to activities or materials used by the business to attract interest and support for the good or service. Examples include free samples, coupons and point-of-purchase displays.
3. **Publicity and public relations**: Publicity refers to any free news story about a business’s products. Public relations are those activities aimed at creating and maintaining favourable relations between a business and its customers.
4. **Advertising**: print or electronic mass media are used to communicate a message about the product. Advertising is used to attract potential customers, create a demand for the product and communicate essential information.
Changes in technology, especially advances in information and communication technology (ICT), are having a significant impact on how businesses promote their products. The internet, for example, has become an effective advertising tool used by businesses to deliver specific messages to its target market. Internet newsgroups, ezines, chat rooms, social networking websites and online publications can all be used in an advertising campaign. The internet has also provided opportunities for many small businesses to undertake more of their own promotional activities (see the following Snapshot).

**SNAPSHOT**

**Social networking allows my small business to have wide exposure.**

Bartlett Precision Manufacturing — social media

There are many benefits to be gained for those small businesses prepared to use social networking or media websites such as Twitter, Facebook and YouTube, especially for marketing their products. If, for example, their marketing is focused on brand recognition, then social networking provides a perfect opportunity for creating that brand recognition. This is exactly the approach taken by Troy Bartlett, owner of Bartlett Precision Manufacturing. Troy uses Facebook and Twitter to provide a unique, personal view into his business, which helps him develop a close connection with his clients. He has established a Facebook-branded page providing details about his business that people can become ‘fans’ of. In turn, all their friends are then introduced to his brand and range of products. He also uses LinkedIn to communicate with other engineers. According to Troy, ‘Social networking allows my small business to have wide exposure in the marketplace’.

**Snapshot question**

Explain the benefits of social media marketing.
Place

The fourth ‘P’ of the marketing mix is ‘place’ or distribution. This refers to activities that make the products available to customers when and where they want to purchase them. A distribution channel is a way of getting the product to the customer. This process usually involves a number of intermediaries or ‘go betweens’, such as the wholesaler or retailer. Apart from the retailer, the other intermediaries are often invisible; that is, the customer knows little about their role and operation. There are three main types of distribution channels:

1. **Producer to customer.** This is the simplest channel and involves no intermediaries. Virtually all services, from tax advice to car repairs, use this method.
2. **Producer to retailer to customer.** A retailer is an intermediary who buys from the producer and resells to customers. This channel is often used for bulky or perishable products such as furniture or fruit.
3. **Producer to wholesaler to retailer to customer.** This is the most common method used for the distribution of consumer goods. A wholesaler is an intermediary who buys in bulk from a producer, then sells in smaller quantities to retailers. Producers will use the services of a wholesaler when a large number of retailers sell the product and the producer finds it difficult to deal with them all.

Summary

- Marketing strategies are actions undertaken to achieve the business’s marketing goals through the marketing mix.
- A business controls four basic marketing strategies to reach its target market: product, price, promotion and place (the four Ps of the marketing mix).
- Products are goods or services, and consist of both tangible and intangible features.
- Packaging helps preserve, inform, protect and promote the product.
- Product branding is the brand and associated brand logo.
- A business must select the most appropriate pricing method suitable to its product and market conditions. Business can choose one of three methods for calculating price: cost-based, market-based and competition-based pricing.
- Promotion refers to the methods used by a business to inform, persuade and remind customers about its products.
- Distribution channels (place) are a way of getting the product to the customer.

Revision

1. **Recall** the four Ps of the marketing mix.
2. **Identify** four intangible benefits that products may provide.
3. **Clarify** the importance of customer service.
4. **Think of a product you recently purchased.** **Identify** the intangible benefits you gained from the product.
5. **Explain** why marketers prefer to use the term ‘total product concept’ rather than simply ‘product’.
6. **Predict** what may happen to the level of sales if a product’s packaging does not match its position.
7. **Explain** the relationship between ‘brand’ and ‘brand logo’.
8. **Account** for why businesses spend so much money attempting to establish a brand name.
9. **Evaluate** each of the following brand names. Indicate the strong points of each name.
   - (a) Nokia mobile phones
   - (b) Apple computers
   - (c) LG electronic products
10. **Summarise** the three main pricing methods.
11 As the manager of a shoe store, you have just received a delivery of new boots that cost you $50 a pair. Your usual mark-up is 60 per cent. However, you find out that yours is the only store in town that will be stocking this fashionable product. **Calculate** what price you will set for the boots. **Explain** your decision.

12 **Outline** the role of promotion.

13 **Recall** what promotion aims to achieve.

14 **Construct** a concept map summarising the four main forms of promotion. The first one has been started for you.

![Product Promotion Strategies](image)

15 **Recommend** a distribution channel for the sale of:
(a) a daily newspaper  
(b) a washing machine  
(c) an imported motor vehicle.

**Extension**

1 When deciding on a brand name and brand logo, **investigate** some of the considerations that a marketer must take into account.

2 **Determine** how a business sets its price when it wants to achieve the objective of profit maximisation.

3 ‘Some people would argue that “marketing ethics” is a contradiction in terms.’ **Evaluate** this statement.

4 Referring to a business you are familiar with, **analyse** and **evaluate** the promotion methods used for one of its goods or services.

5 Using magazines, newspapers and the internet, collect and paste into your notes five advertisements for small businesses.
   (a) **Identify** the good or service the business is selling.
   (b) **State** what unique features of the business are publicised.
   (c) **Determine** whether you think the advertisement fulfils its function of reminding, informing and persuading existing and potential customers. Give reasons for your answer.
   (d) Rank the advertisements in the order that they appeal to you, from the most appealing to the least appealing. **Explain** how you determined the ranking order.
   (f) **Compare** your ranking with other members of the class and discuss similarities and differences.

8.5 **Finance**

A thorough understanding of accounting and finance is essential for business managers. Accounting is a management tool that is concerned with providing information on the financial affairs of a business, while finance is concerned with where the business sources its funding.
Management of business finance is a crucial aspect of business success. Management of finance starts with sourcing — where will the funding come from? Once a business has secured funding, it then needs to ensure that it is applied appropriately. All financial managers would be aware of the need to manage the cash flow of the business. Cash flow is sometimes described as the ‘lifeblood’ of business. The management of cash flow involves anticipating cash expenditure and ensuring that enough of the income earned comes in the form of cash. A further challenge is to ensure that enough money is saved in the event of unexpected challenges. Some money for contingencies needs to be put aside. Contingencies are unanticipated events that can lead to financial difficulty. For a business to be well managed, it needs to have saved money for such events because they can place the business under unexpected financial pressure.

A business that is well managed will have a good credit rating, which means that lenders will be prepared to lend the business money because they know that it is safe for them to do so. The credit rating is determined by financial organisations that assess the capacity of the business, both to repay debt and manage finances responsibly. If a business has a good credit rating, lenders will readily provide funds. The business can use borrowings to its advantage. Thus, if it wants to expand operations, update technology or open offices overseas, it probably will be able to get the money to do so.

In short, business leaders and managers need to have a good understanding of accounting and finance, and need to draw on this knowledge and skill when managing all aspects of the business.

The HSC course investigates finance in greater depth, so this chapter will provide an elementary understanding of the main concepts.

**Accounting — introduction and scope**

**Accounting** is a managerial and administrative tool that involves the recording of financial transactions, so that a clear summary of what has happened to the money coming in and going out can be traced over time. Every financial transaction, from the ordering of stock to the sale of an old stock item, is recorded. These records (which include delivery dockets, sales receipts, invoices, cash register records and e-payment transactions, to name a few) are entered into accounts that may be either computerised or manual (in the form of books). The information in these accounts is then summarised into financial reports and statements that provide very valuable information about the trading period (see table 8.4 on page 230). The statements are set out in a standard format so that they are easy to read and understand. A well-trained manager can use these statements to get a very accurate picture of the financial status of the business.

**BizWORD**

Contingencies are unanticipated events that can lead to financial difficulty. For a business to be well managed, it needs to have saved money for such events.

**BizFACT**

During a recent economic downturn, many businesses experienced financing difficulties. Although the cost of finance fell, so did the availability. Businesses that were well managed financially found that the downturn reduced their revenues. The cost of their borrowed funds fell, however, which meant many repaid debt more quickly than they had originally expected.

**FIGURE 8.29** Accounting is more than ‘crunching the numbers’. Money is the lifeblood of all businesses. The rate at which it flows into or out of the business determines whether the business is expanding and successful. There is only one sure way to measure the flow of money — develop a system of financial records. No business, no matter how small, can survive without a sound accounting system.
The three main accounting/financial reports or statements are shown in Table 8.4.

**TABLE 8.4** The main accounting/financial reports or statements

<table>
<thead>
<tr>
<th>Name of statement/report</th>
<th>Description of the statement/report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash flow statements</td>
<td>Indicate the movement of cash receipts and cash payments resulting from transactions over a period of time.</td>
</tr>
<tr>
<td>Income statements (also called statement of financial performance, revenue statement or profit and loss (P&amp;L) statement)</td>
<td>Show the revenue earned and expenses incurred over the accounting period with the resultant profit or loss.</td>
</tr>
<tr>
<td>Balance sheets (also called statement of financial position)</td>
<td>Represent a business’s assets and liabilities at a particular point in time and represent the net worth of the business.</td>
</tr>
</tbody>
</table>

A business is an economic entity — it trades within society and has responsibility both to its internal and external stakeholders (i.e. the members of society who are directly and indirectly affected by the affairs of the business). Accounting provides information that is valuable to managers. It also provides information to employees, owners and shareholders (if it is a company), suppliers, lenders, customers, government (including regulators), competitors and the general public.

**BizFACT**
The main purpose of financial statements is to summarise information in a way that is useful for interested parties. Together the reports show accurately how the business is placed financially.

**Figure 8.30** The stakeholders interested in the accounting information given by business

Accounting is useful, as it provides information in statements about each of the following as it relates to the business:
- financial status/position
- cash status/position
- financing or funding information
- cash flows
• profitability and return on investment
• trends in earnings, borrowings, sales and so on that together indicate the risks the business faces.

The main purpose of accounting then is to provide information that is useful and accurate, and presented in a clear and concise form. This information will encourage:
• judicious and prudent financial decision making
• planning that is purposeful
• confidence in the business’s management
• accountability, or stewardship.

Sasy n Savy — the importance of accounting

Accounting is the process that allows a business to control basic areas such as cash control (making sure there is enough cash to keep the business operating day to day) and pricing. For Samea Maakrun, who owns Sasy n Savy, this means keeping a lid on costs, making sufficient profit and reinvesting some profit into growing the business.

Sasy n Savy manufactures natural and organic bath, body and hair care products, utilising Australian plants and herbs. With 10 staff and four contractors in Australia, and agents in Hong Kong and London, Samea sells in Australia at selected retailers, and online through her website. She is a qualified accountant and is proud to run a debt-free and cash flow positive business.

However, accounting is not just about maintaining financial records. It also focuses on making sure the business complies with taxation obligations, such as GST and income tax. Determining the best price for making a profit is another important area of accounting. Sasy n Savy does this by targeting the middle to upper end of the market. Its prices are still affordable, however, and the business emphasises quality in its products.

Snapshot question
Outline the role of accounting for Samea Maakrun’s business.

Finance — introduction and scope

Finance refers to how a business funds its activities — for instance, where it gets the money to trade, why it chooses to use certain lenders — as well as the costs, risks, terms and benefits of different types of borrowings. Financial knowledge requires an understanding of a range of financial instruments. Businesses, even very small ones, generally borrow money at some time — usually when they first set up.

It is vital for a business to be able to manage its borrowing and to use appropriate types of borrowing — namely types that match its earning stream and capital/asset structure. Borrowing represents a useful source of finance — but it is one that comes at a price. It is management of the cost and risk of finance that is the key to successful financial management.

Cost management is crucial because businesses tend to try to maximise profits. In today’s highly competitive markets, in Australia and globally, a business succeeds when it can minimise cost (while maintaining quality, reliability, high service levels

SNAPSHOT

• accounting is not just about maintaining financial records.

BizWORD

Accountability occurs when a business acts in the best and highest interests of its owners. Full and complete ‘disclosure’, which means to be open and not hide the truth, ensures that the books of account are kept accurately and that the information reflected in them, and which is summarised in reports, is based on the true and actual transactions. Another term for accountability is stewardship.

Finance refers to how a business funds its activities — for instance, where it gets the money to trade, why it chooses to use certain lenders — as well as the costs, risks and benefits of different types of borrowings.
and so on). Risk management is crucial because businesses can be uncertain regarding their chances of making financial losses. Astute financial management is therefore considered indispensable to business.

An understanding of both accounting and finance is absolutely necessary if business managers and owners are to make informed decisions. The ability to interpret financial information helps with the leadership task — which includes planning for future activities; choosing between alternative courses of action when presented with business problems; organising the resources required to produce a product or service; and then effectively researching and marketing it; and controlling and monitoring spending in all aspects of the business.

**Summary**

- Businesses need to be led by managers with a good understanding of accounting and financial management.
- Accounting is a financial management tool that is involved with the recording and analysis of all the business’s financial transactions.
- The financial transactions are summarised into financial statements. The main ones are:
  - cash flow statement
  - income statement
  - balance sheet.
- Finance details how a business funds its activities.
- It is vital for a business to be able to manage its borrowings and to use appropriate types of borrowings.

**Revision**

1. **Distinguish** between accounting and finance.
2. **Recall** what the management of cash flow involves.
3. **Clarify** why some money for contingencies needs to be put aside.
4. **State** what a credit rating assesses.
5. **Explain** why a business would want to have a good credit rating.
6. **State** why accounting is necessary for business.
7. **Identify** the main accounting reports and statements.
8. **Discuss** the role of the internal and external stakeholders who would be interested in the financial situation of the business.
9. **Recall** five reasons why accounting is useful for business.
10. **Explain** the importance of accountability.
11. **Demonstrate** why astute financial management is considered indispensable to business.

**Extension**

1. Use the Australian Accounting Standards Board (AASB) weblink in your eBookPLUS to find out more about the organisation. **Investigate** how accounting standards are developed and implemented.
2. ‘Shrinkage’ refers to the loss of stock from a business. White-collar crime refers to the theft or embezzlement of money from a business. **Analyse** the proposition that: ‘if employees were paid higher wages, then there would be no need to audit as there would be no need for anyone to steal from businesses’.
3. Use the Count weblink in your eBookPLUS to research an auditing firm. **Determine** the range of financial services the firm offers and present an advertisement for the business to the class.
4. **Assess** the effect of an economic downturn on a business’s financial management.
Financial statements

Introduction to financial statements

All business owners must be able to make judgements about the direction of the business at any given time. To help them achieve this, they need to prepare some financial statements — reports that summarise transactions over a period of time. The main accounting reports and financial statements are cash flow statements, income statements and balance sheets. Business owners, for example, will need to be aware of whether the cash flow through the business is sufficient to allow the business to pay its debts on time, whether or not the business is trading profitably, and the financial status of the business.

Cash flow statements

A cash flow statement is a financial statement that indicates the movement of cash receipts and cash payments resulting from transactions over a period of time. Cash flow statements are vital for the business to assess whether money inflows can match money outflows. The term ‘liquidity’ is often used to describe whether a business has a good or adequate cash flow. Figure 8.31 summarises the typical monetary inflows and outflows. A business is said to be liquid (or solvent) if it has the cash available to meet payments as they are due. Generally a business would prefer its sales to be in cash for precisely this reason — it has a need for cash to meet its own payments. Why do businesses allow credit sales when they prefer cash? This is because they need to match their desire for cash with the customer’s ability to pay. By allowing customers to purchase on credit, the business will obtain sales it might otherwise lose.

Examine effective cash flow management

Cash flow statements are closely related to budgets, which are estimates of anticipated future cash flows. Cash flow statements, however, are broader than budgets because they are also used to summarise past information. Cash flow
statements are vital for the information they give on the timing of payments and receipt of income. A business will keep information on cash movements because this will help it predict future cash flows and hence make provision for payments. A typical cash flow statement can be seen in figure 8.32.

| Cash Flow Statement for Plant 1 (first quarter, 2015) |
|-----------------------|-----------------------|-----------------------|
|                       | January $ | February $ | March $ |
| Cash at beginning of year | 15 500   | 26 000   | 1 119 500 |
| Cash inflows           |           |           |         |
| Sales:                 |           |           |         |
| retail                 | 20 000   | 23 000   | 54 000  |
| public                 | 33 000   | 36 500   | 123 000 |
| other manufacturers    |           |           |         |
| A                      | 1 000 500| 2 560 000| 2 600 000|
| B                      | 250 000  | 250 000  | 250 000 |
| C                      | 3 400 000| 3 200 000| 2 800 000|
| Total inflows          | 4 703 500| 6 069 500| 5 827 000|
| Cash outflows          |           |           |         |
| Raw materials          | 3 650 000| 3 760 000| 4 720 000|
| Service costs          | 23 000   | 23 000   | 23 000  |
| Leases                 |           |           |         |
| forklifts              | 11 000   | 11 000   | 11 000  |
| equipment              | 125 000  | 125 000  | 125 000 |
| Wages                  | 850 000  | 990 000  | 980 000 |
| Other                  | 34 000   | 60 000   | 61 000  |
| Total outflows         | 4 693 000| 4 976 000| 5 920 000|
| Cash surplus/(deficit) | 10 500   | 1 093 500| (93 000) |
| Cash at end of year    | 26 000   | 1 119 500| 1 026 500|

**FIGURE 8.32** Typical cash flow statement

A study of the cash flow statement (see figure 8.32) of a manufacturer shows that this business made a cash surplus for two of its first three months of trading for the year the report was made. You can see that the business made a small surplus in January and a large surplus in February. However, in March, this business experienced a cash deficit. It should be clear now why such statements are necessary. A business can track its inflows and outflows over a period of time. It can then use these statements to determine why the inflows and outflows are taking the pattern they are. For example, in January, sales to manufacturer A were down on the usual $2.5 million average. This may have been due to the normal business lull in January. The surplus for February is quite high and an astute manager would have ensured that a portion of this surplus was put aside in case it was needed in future months. As it turned out, the materials costs for March were very high and sales to manufacturer C continued to fall.

The business can see that it needs to take some remedial action. In the short term, if these trends continue, the business could cover cash deficits with the large surplus it made in February. It would not, however, want the pattern of deficits to continue, so managers need to make some decisions. For example, they might ask where they can obtain a regular supply of cheaper raw materials. They could also look at diversifying their sales base.

By using cash flow statements in this way, a business is able to both control finances and plan strategies for financial benefit. Cash flow reporting can be used to plan and predict future cash flow inflows. Outflows tend to follow trends, with some variations over time.
Cash flow statements for larger businesses

While the cash flow statements previously shown are very detailed, they are more suited to small to medium sized businesses. The format of cash flow statements used by large businesses and public companies is shown in figure 8.33.

<table>
<thead>
<tr>
<th>Reflections Images Ltd</th>
<th>$000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Cash flows from operating activities</strong></td>
<td></td>
</tr>
<tr>
<td>Sales</td>
<td>600</td>
</tr>
<tr>
<td>Payments for stock</td>
<td>(200)</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>(150)</td>
</tr>
<tr>
<td><strong>Net cash flow from operating activities</strong></td>
<td>250</td>
</tr>
<tr>
<td><strong>Cash flows from investing activities</strong></td>
<td></td>
</tr>
<tr>
<td>Sales of non-current assets</td>
<td>500</td>
</tr>
<tr>
<td>Purchase of non-current fixed assets</td>
<td>(200)</td>
</tr>
<tr>
<td><strong>Net cash flow from investing activities</strong></td>
<td>300</td>
</tr>
<tr>
<td><strong>Cash flows from financing activities</strong></td>
<td></td>
</tr>
<tr>
<td>New borrowing and currently raised debt</td>
<td>0</td>
</tr>
<tr>
<td>Changes in share capital</td>
<td>100</td>
</tr>
<tr>
<td><strong>Net cash flows from financing activities</strong></td>
<td>100</td>
</tr>
<tr>
<td><strong>Net cash increase/(decrease) from all activities</strong></td>
<td>650</td>
</tr>
<tr>
<td>Opening cash balance</td>
<td>(340)</td>
</tr>
<tr>
<td><strong>Closing cash balance</strong></td>
<td>310</td>
</tr>
</tbody>
</table>

FIGURE 8.33 The format of cash flow statements for large businesses and public companies

It can be seen from figure 8.33 that there are various classifications of cash that derived from operating, investing and financing activities. These terms are distinguished below:

- **Cash from operating activities** — these are the cash inflows and outflows relating to the main activity of the business; that is, the provision of goods and services.
- **Cash from investing activities** — these are the cash flows related to the purchase and sale of non-current assets and investments.
- **Cash from financing activities** — these are cash flows related to the acquisition and repayment of both debt and equity finance.

**Summary**

- There are three main financial statements created by accounting processes: the cash flow statement, the income statement (also called revenue statement, profit and loss (P&L) statement or statement of financial performance), and the balance sheet (or statement of financial position).
- A cash flow statement shows the movement of cash receipts (inflows) and cash payments (outflows) over a period of time.
- Liquidity is used to describe whether a business has a good or adequate cash flow.
- Cash flow reports are vital for the information they give on the timing of payments and receipts of income.
- Cash flow statements are divided into three categories: cash flows from operating activities, those from investing activities and those from financing activities.

**Revision**

1. Briefly **outline** what a cash flow statement is used for.
2. **Define** the term ‘liquidity’.
3. **Recall** why businesses allow credit sales when they prefer cash.
4 Explain the effect (short-term and long-term) of a bank loan on a business’s cash flows.

5 Classify each of the following items as either a cash inflow or cash outflow, stating your reason for each item.
   (a) Credit sales
   (b) Purchases of stock
   (c) Payments of wages
   (d) Tax on income earned
   (e) Sales returned
   (f) Debtor payments
   (g) Creditor payments

6 Examine why a retailer may have a variable cash inflow, depending on the time of year.

7 Explain how a cash flow statement may be used to give a detailed insight into the financial situation facing a business.

8 Distinguish between the following cash flow items: those arising from operations, those arising from financing, and those arising from investing activities.

9 Juanita owns a craft shop. During July the business sold $8200 of craft goods and received $200 in bank interest. She paid her sales assistant a monthly wage of $1350. During this month, the business spent $2800 on craft equipment, $350 on rent, $750 on insurance and $150 on electricity.
   (a) Construct a cash flow statement for the month of July for Juanita’s business.
   (b) Calculate the business’s closing cash balance for July if the opening cash balance was $3500.

**Extension**

1 Cash is often referred to as the ‘life-blood’ of any business. Analyse the effects on a business of carrying too little cash, and outline the problems that could arise if a business carries too much cash.

2 Creditors, or accounts payable, are liabilities owed by the business that are due and payable. Debtors, or accounts receivable, are monies owed to the business by customers. Assess how delays in the receipt and payment of cash can have a large effect on a business’s cash flow.

3 Research the terms ‘liquidity’ and ‘profitability’. Distinguish between these terms and explain how sometimes a business will seek greater liquidity for lower profitability (Hint: You might like to consider factoring, sale and leaseback, and inventory controls).

**BizWORD**

The income statement, or statement of financial performance, is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.

**Income statement**

The income statement has also been called the statement of financial performance. This alternative title makes the intent and the content of the statement clear. It has had other names including revenue statement, and profit and loss (P&L) statement.

The income statement is a summary of the income earned and the expenses incurred over a period of trading. It helps users of information see exactly how much money has come into the business as revenue, how much has gone out as expenditure and how much has been derived as profit.

As outlined in chapter 1, profit refers to money earned by a business in the course of operating that is in excess of costs; that is, money left after expenses are covered. Mathematically, it is simply the income (or revenue) from all sources less all costs (or expenses).

<table>
<thead>
<tr>
<th>Income statement for year ended 30 June 2011</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from sales</td>
<td>2 000 000</td>
</tr>
<tr>
<td>Less cost of goods sold (COGS)</td>
<td>1 000 000</td>
</tr>
<tr>
<td>Gross profit</td>
<td>1 000 000</td>
</tr>
<tr>
<td>Less expenses</td>
<td>500 000</td>
</tr>
<tr>
<td>Net profit</td>
<td>500 000</td>
</tr>
</tbody>
</table>

**FIGURE 8.34** Typical income statement (or statement of financial performance) format (simple)
Figure 8.34 is a simple income statement that enables you to see the general format. There are several important features to note. First, the statement must have a heading that states the period of time over which the business was operating for the purposes of the statement. Usually this is one year, but it may be half yearly, quarterly, or even every month or six weeks.

Second, there are only five main categories of items:
1. revenue or income
2. cost of goods sold (COGS)
3. gross profit
4. expenses
5. net profit.

Third, the income earned (or revenue) is always stated at the top of the report. If the business had absolutely no expenses then this would be the profit figure. This is not realistic. In truth, the business would have had costs that arose from selling. So, we then deduct the expenses that occurred while the income was being earned.

This is done in three steps:
1. List the sales for the period.
2. Calculate cost of goods sold (COGS) and calculate the gross profit.
3. Itemise all other expenses (which may be classified into administrative, selling and financial expenses) and calculate the net profit.

**Net sales**

Net sales are the amount of revenue a business has earned from sales when the effects of sales returns are deducted.

Revenue generally means income from sales. Sometimes the business will offer discounts to customers who pay outstanding amounts quickly. Such discounts reduce the business income and must be deducted from the calculation of profits. Similarly, when customers return goods, the cost of those goods must be deducted from sales figures. This is the way to work out net sales in the revenue statement:

\[
\begin{array}{l}
\text{Sales} \quad 100,000 \\
\text{Less discounts allowed to customers} \quad 2,000 \\
\text{Less returns of sold items} \quad 3,000 \\
\text{Net sales} \quad 95,000 \\
\end{array}
\]

**Gross profit and cost of goods sold (COGS)**

**Gross profit** is the term given to the sales less cost of goods sold (COGS) or, mathematically:

\[
\text{Gross profit} = \text{Sales} - \text{COGS}
\]

The gross profit calculation is important as, essentially, it tells the business how much its mark-up is on the cost price of the goods it has sold. This varies somewhat from business to business but is generally between 50 and 100 per cent. If the mark-up was enormous (say 800 or 1000 per cent), then it would attract other businesses to compete in the market.

The cost of goods sold is an expense to the business. However, it is not grouped with other expenses. This is because the mark-up (or ‘contribution margin’) on
the cost of goods sold determines the level of overall income. In a service-based business, there is no stock and therefore no mark-up. Therefore, income and gross profit are the same. Cost of goods sold affects only businesses that on-sell items they have purchased.

The calculation for COGS is determined as shown below:

\[ \text{COGS} = \text{Opening stock} + \text{Purchases} - \text{Closing stock} \]

**Opening stock** is the value of stock (or inventory) that the business has at the start of the financial year. **Closing stock** is the value of stock on hand at the end of the financial year. Here is an example showing how COGS is calculated:

\[
\begin{align*}
\text{COGS} & = \text{Opening stock ($2500)} + \text{Purchases ($10 250)} - \text{Closing stock ($3400)} \\
& = $12 750 - $3400 \\
& = $9350
\end{align*}
\]

**Other expenses and separation of the expenses by type**

**Expenses** are simply costs. Specifically, expenses are the costs incurred in the process of acquiring or manufacturing a good or service to sell and the costs (direct and indirect) associated with managing all aspects of the sales of that good or service. Expenses must always be subtracted from income to work out net profit. Although not always shown, it is very useful to separate the expenses by type because this helps users of the financial information to target problem areas quickly. In this part of the statement, all the expenses that do not form part of the cost of goods are listed.

The expenses are broken down specifically into three types. These are shown in figure 8.35.

<table>
<thead>
<tr>
<th>Selling expenses:</th>
<th>Expenses*</th>
<th>Financial expenses:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commission</td>
<td>Stationery</td>
<td>Interest payments</td>
</tr>
<tr>
<td>Salaries</td>
<td>Office salaries</td>
<td>Lease payments</td>
</tr>
<tr>
<td>Wages</td>
<td>Rent</td>
<td>Dividends</td>
</tr>
<tr>
<td>Advertising</td>
<td>Rates</td>
<td>Insurance payments</td>
</tr>
<tr>
<td>Delivery expenses</td>
<td>Telephone</td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>Depreciation on buildings</td>
<td></td>
</tr>
<tr>
<td>Depreciation on shop fittings</td>
<td>Audit fees</td>
<td></td>
</tr>
</tbody>
</table>

**Administrative expenses:** These relate to the process of selling the good or service and can be directly traced to the need for sales.

**Finance expenses:** Costs directly related to the general running of the business.

\*Costs of goods sold (COGS): this expense includes only the cost of stock sold and is shown separately in the income statement (or statement of financial performance).

**FIGURE 8.35** Income statement (or statement of financial performance) expense breakdown by type
Net profit

The final step in the completion of the income statement is to determine the net profit. A net profit is the amount remaining when operating and non-operating expenses are deducted from gross profit.

Net profit is shown mathematically as:

$$\text{Net profit} = \text{Gross profit} - \text{Expenses}$$

If all this information is combined, we can draw a much more realistic income statement (see figure 8.36).

The income statement is always the first one to be compiled at the end of the accounting period. This is because the figures from it are used in the next statement — the balance sheet (or the statement of financial position).

When compiling the income statement, the manager should be mindful of several things — the proportion of gross and net profit to sales and also the level of expenses that accrue to selling, administration and finance. Because the reports collect and summarise a large amount of information, they also provide insight into how the business is both earning and spending. This insight is extremely valuable, especially when analysing the statements at the end of the accounting or operating period. The manager would also be aware that the ‘bottom line’, or net profit, figure, provides more important information than gross profit, which is really only a measure of the mark-up or contribution margin.

U Win Pty Ltd income statement for year ended 30 June 2015

<table>
<thead>
<tr>
<th></th>
<th>$</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>5 000 000</td>
<td></td>
</tr>
<tr>
<td>Less COGS</td>
<td>3 200 000</td>
<td></td>
</tr>
<tr>
<td>Gross profit</td>
<td>1 800 000</td>
<td></td>
</tr>
<tr>
<td>Less expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(a) Selling expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>advertising</td>
<td>200 000</td>
<td></td>
</tr>
<tr>
<td>sales salaries</td>
<td>300 000</td>
<td></td>
</tr>
<tr>
<td>depreciation on cars</td>
<td>10 000</td>
<td></td>
</tr>
<tr>
<td>delivery</td>
<td>3 000</td>
<td></td>
</tr>
<tr>
<td>telephone</td>
<td>9 000</td>
<td>522 000</td>
</tr>
<tr>
<td>(b) Administration expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>office salaries</td>
<td>400 000</td>
<td></td>
</tr>
<tr>
<td>depreciation on fixtures</td>
<td>5 500</td>
<td></td>
</tr>
<tr>
<td>stationery</td>
<td>1 500</td>
<td></td>
</tr>
<tr>
<td>security</td>
<td>12 000</td>
<td></td>
</tr>
<tr>
<td>rent</td>
<td>62 500</td>
<td></td>
</tr>
<tr>
<td>insurances</td>
<td>3 500</td>
<td>485 000</td>
</tr>
<tr>
<td>(c) Financial expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>interest</td>
<td>125 000</td>
<td></td>
</tr>
<tr>
<td>insurances</td>
<td>6 000</td>
<td></td>
</tr>
<tr>
<td>leases</td>
<td>6 000</td>
<td>137 000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1 144 000</td>
</tr>
<tr>
<td>Net profit</td>
<td></td>
<td>656 000</td>
</tr>
</tbody>
</table>

FIGURE 8.36 Typical income statement (or statement of financial performance) format (complex)
Summary

- The income statement is a summary of the income earned and the expenses incurred over a trading period.
- The main classification of items in the income statement are revenues, cost of goods sold (COGS) and expenses.
- Gross profit = Sales − Cost of goods sold (COGS)
- COGS = Opening stock + Purchases − Closing stock
- Expenses are simply costs and can be broken down into selling, administrative or financial.
- Net profit = Gross profit − Expenses

Revision

1. Identify the different names given to the income statement.
2. Define each of the following terms and, where relevant, write down the mathematical equation that would help in calculating the figure.
   - Sales
   - Cost of goods sold
   - Gross profit
   - Net profit
3. Calculate the cost of goods sold (COGS), given the following information:

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>700,000</td>
</tr>
<tr>
<td>Stock (opening)</td>
<td>100,000</td>
</tr>
<tr>
<td>Purchases of stock</td>
<td>400,000</td>
</tr>
<tr>
<td>Closing stock</td>
<td>50,000</td>
</tr>
</tbody>
</table>
4 Using the figures from question 3 above, calculate gross profit.
5 Using your workings from questions 3 and 4, calculate the value of net profit (or loss) if expenses for the period totalled $80 000.
6 Anita Toparis owns and operates Peta's Florist. Last year Anita had a sales revenue of $285 000. Her cost of goods sold totalled $115 000. Her operating expenses were: electricity $5000, advertising $11 000, interest charges $5000, salaries $62 000 and rent $25 000. Construct an income statement (statement of financial performance) for Anita and tell her whether she has made a net profit.
7 Distinguish between selling, administrative and financial expenses, giving examples for each.
8 Explain how an income statement can provide useful information to a business and its stakeholders.

Extension

1 Research each of the following items that can be found in an income statement, define each, and determine where it would be found (under revenue, cost of goods sold, or expenses).
   (a) Cartage inwards
   (b) Cartage outwards/freight
   (c) Commissions
   (d) Bad debts
   (e) Depreciation
   (f) Interest
   (g) Security
2 Use the information below to construct an income statement (statement of financial performance) for Sathya's Skatehouse:

<table>
<thead>
<tr>
<th></th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from cash sales</td>
<td>500 000</td>
</tr>
<tr>
<td>Purchases for the period</td>
<td>50 000</td>
</tr>
<tr>
<td>Salesperson's wages</td>
<td>80 000</td>
</tr>
<tr>
<td>Insurance</td>
<td>2 000</td>
</tr>
<tr>
<td>Opening stock</td>
<td>100 000</td>
</tr>
<tr>
<td>Rent</td>
<td>20 000</td>
</tr>
<tr>
<td>Advertising costs</td>
<td>10 000</td>
</tr>
<tr>
<td>Interest costs</td>
<td>2 500</td>
</tr>
<tr>
<td>Closing stock</td>
<td>20 000</td>
</tr>
<tr>
<td>Telephone</td>
<td>15 000</td>
</tr>
<tr>
<td>Rates</td>
<td>3 500</td>
</tr>
<tr>
<td>Revenue from credit sales</td>
<td>50 000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>4 000</td>
</tr>
<tr>
<td>Electricity</td>
<td>2 100</td>
</tr>
<tr>
<td>Water</td>
<td>3 500</td>
</tr>
<tr>
<td>Lease costs (machinery)</td>
<td>5 500</td>
</tr>
</tbody>
</table>

Balance sheets

The balance sheet, sometimes called the statement of financial position, is used to help owners keep a watch on their debt and equity levels, compare their overall financial position with that of previous periods, and assist with the process of financial decision making. It is a report that shows the overall financial stability of the business. A typical balance sheet is shown in figure 8.38.

There are several things to note about the balance sheet. First, its heading denotes that it is a snapshot of the business’s financial position as at a particular point in time. Second, if a line is drawn between the two columns of figures, the sum of items on the left-hand side ‘assets’ is equal to, or balances, the sum of items on the right-hand side (liabilities and owner’s equity). This format for a balance sheet is called the ‘T-format’ because we can draw a line down the middle and separate the report into two halves by using the letter T. An alternative format, the narrative format, is explored in Year 12.

BizWORD

A balance sheet represents a business’s assets and liabilities at a particular point in time, expressed in money terms, and represents the net worth of the business.
Balance sheet for Real Quest P/L as at 30 June 2015

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>Current liabilities</td>
</tr>
<tr>
<td>$4 000</td>
<td>Accounts payable</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>550</td>
</tr>
<tr>
<td>$6 000</td>
<td>Bank overdraft</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>1 200</td>
</tr>
<tr>
<td>$6 000</td>
<td>Credit cards</td>
</tr>
<tr>
<td>Stock</td>
<td>6 200</td>
</tr>
<tr>
<td>$10 000</td>
<td>Accrued expenses</td>
</tr>
<tr>
<td>$26 000</td>
<td>$550</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Non-current assets</strong></th>
<th><strong>Total current liabilities</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Land and buildings</td>
<td>$8 500</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td></td>
</tr>
<tr>
<td>Intangibles</td>
<td></td>
</tr>
<tr>
<td>$50 000</td>
<td></td>
</tr>
<tr>
<td>$10 000</td>
<td></td>
</tr>
<tr>
<td>$45 000</td>
<td></td>
</tr>
<tr>
<td>$105 000</td>
<td></td>
</tr>
</tbody>
</table>

Total current assets $26 000 Total current liabilities $8 500

Total non-current assets $105 000 Total liabilities $73 500

**Owner's equity**

<table>
<thead>
<tr>
<th>Owner's capital</th>
<th>Retained profits</th>
<th>Total owner's equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>$35 000</td>
<td>$21 500</td>
<td>$56 500</td>
</tr>
</tbody>
</table>

Total assets $131 000 Total liabilities and owner's equity $130 000

FIGURE 8.38 Typical balance sheet (or statement of financial position) showing division into main parts

Balance sheet items

You will notice that the balance sheet is divided into two parts as shown in figure 8.38. On the left-hand side are recorded the assets — the things the business owns. On the right-hand side are recorded the liabilities and owner’s equity — the things the business owes.

Assets

**Assets** are items of value owned by the business that can be given a monetary value. Assets can be divided into several different types: current and non-current, tangible and intangible.

**Current assets** are assets that a business can expect to use up, or turn over, within 12 months. Examples include cash, accounts receivable (also called debtors) and inventories (stock).

**Non-current assets** are those assets that have an expected life of longer than 12 months. These include large physical items such as buildings, land, machinery, technology, vehicles, furniture, fixtures and fittings.

**Intangible** items are also included here. Intangible items are things of worth that have no physical substance. Examples include goodwill, trademarks, designs, copyright and patents. A good name or reputation (‘goodwill’) or an easily identifiable logo obviously has worth — but how do you value in dollar terms something like good product design, a creative staff or reputation? Nevertheless, intangible assets are a resource that the firm owns and must be recorded in the accounts.

Liabilities

**Liabilities** are items of debt owed to outside parties and/or other organisations (like suppliers or the banks) and include loans, accounts due to be paid by the business,
mortgages, credit card debt and accumulated expenses. The business will divide
the liabilities into current and non-current items.

Current liabilities are those in which the debt is expected to be repaid in the short
term (12 months or less) and include bank overdrafts, credit card debts, accounts
payable (also called creditors) and accrued expenses.

Non-current liabilities are long-term debt items such as mortgages, leases,
debentures and retirement benefit funds (money owed to employees upon their
retirement from the business). Some of these non-current liabilities can last up to
30 years.

Owner’s equity
The owners give a business money for it to acquire resources and begin operating.
This money is called owner’s equity (capital). As the business operates,
the business should start to earn an income to cover its costs and then later earn a profit.
The business can hold or retain these profits to target money for a particular
project or it may put money into ‘reserves’ for distribution later. The business
could also choose to repay the owners who invested their money in the business
at the outset.

Over time, a successful business will have its owner’s equity amount increase in
value. This means that the owner’s claim on the business will also increase. This
is the owner’s reward for risking their money — and is also the reason for people
investing in the stockmarket long term.

Owner’s equity is considered to be a liability from the point of view of the
business, because it is a type of debt the business carries. However, unlike liabilities,
owner’s equity is a debt owed to owners because of the risk they took in investing
in the business.

Summary
• The balance sheet shows the overall financial stability of the business.
• The main items in the balance sheet are assets, liabilities and owners’ equity.
• Assets are items of value to the business and can be either current or non-
current.
• Liabilities are debts or business borrowing and can be either current or non-
current.
• Owner’s equity items refers to the owners’ claims and is considered a liability
from the point of view of the business.

Revision
1 Identify the alternative title used for a balance sheet.
2 Outline the purposes of a balance sheet.
3 Identify what is meant by the term ‘T-format’ used to describe the balance sheet.
4 Account for the fact that the balance sheet is called a ‘balance’ sheet with reference
to both sides of the statement.
5 Define, with examples, what is meant by the term ‘assets’.
6 Distinguish between current and non-current assets, with examples of each.
7 Outline the intangible items of a balance sheet.
8 State what liabilities are, and distinguish between those that are current and those
that are non-current.
9 Explain how the business owes owners both their investment and also a return for
their investment.

BizWORD
Owner’s equity is the funds contributed by the owner(s) to establish and build the business. It is
also called “capital”.

Weblink
Use the Balance sheet weblink in your eBookPLUS to learn more about balance sheets, including a balance
sheet template.
10 The balance sheet below as at 30 September has been badly prepared. Construct the balance sheet correctly.

**Balance sheet as at 30 September**

<table>
<thead>
<tr>
<th>Assets</th>
<th>$</th>
<th>Liabilities</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank</td>
<td>3,400</td>
<td>Motor vehicles</td>
<td>30,000</td>
</tr>
<tr>
<td>Creditors</td>
<td>2,500</td>
<td>Debtors</td>
<td>2,000</td>
</tr>
<tr>
<td>Capital</td>
<td>46,000</td>
<td>Stock of materials</td>
<td>1,600</td>
</tr>
<tr>
<td>Loan</td>
<td>10,000</td>
<td>Owner’s equity</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Equipment</td>
<td>23,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>+ Drawings</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>− Net profit</td>
<td>5,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>61,900</td>
</tr>
</tbody>
</table>

**Extension**

1 **Determine** why increases in business wealth add to the owner’s equity amount and thereby increase the wealth of those investing in business.

2 **Account** for the fact that the income statement will always be drawn up before the balance sheet.

3 Intangibles are subjectively valued, whereas tangible assets are more easily objectively valued. **Extrapolate** why the value of intangibles — such as goodwill, trademarks, designs, copyright and patents — are very hard to value, while the value of buildings and vehicles can be easier to determine.

4 In accounting, the true value of assets — such as buildings and land (which may be revalued upwards), vehicles (which may be valued downwards) and goodwill — is reflected in accounts as ‘depreciation’, ‘amortisation’ or ‘revaluation reserves’. Research these terms and **analyse** how they are used to find a truer picture of the value of a business’s assets.

**The balance sheet equation**

The balance sheet is called the balance sheet for a good reason — it should always balance. This means that the sum of items on the left-hand side (the assets) must total the sum of items on the right-hand side (liabilities and owner’s equity). This is summarised in the balance sheet equation below.

\[
A = L + OE
\]

Where:

- **A** = Assets
- **L** = Liabilities
- **OE** = Owner’s equity

You will immediately see that the balance sheet is set out in a way that mirrors the accounting equation, with assets on the left, and liabilities and owner’s equity on the right.
Example 1

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
<th>Owner's equity</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>145 000</td>
<td>110 000</td>
</tr>
</tbody>
</table>

Since

A = L + OE then we can say $145 000 = $110 000 + OE.
Therefore owner's equity must be $35 000.

Example 2

<table>
<thead>
<tr>
<th>Accounts receivable</th>
<th>$12 000</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fresh at bank</td>
<td>$65 000</td>
<td>A/cs Pay.</td>
</tr>
<tr>
<td>Mortgage</td>
<td>$250 000</td>
<td>Visa Card debt</td>
</tr>
<tr>
<td>Capital</td>
<td>$230 000</td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$3 000</td>
<td></td>
</tr>
<tr>
<td>Visa Card debt</td>
<td>$6 500</td>
<td></td>
</tr>
<tr>
<td>Land and buildings</td>
<td>$77 000</td>
<td></td>
</tr>
</tbody>
</table>

Step 1: Identify all assets, liabilities and owner's equity items and group them as shown (into the format of the balance sheet).

Step 2: Apply the equation and find the unknown quantity.

A = L + OE

$77 000 + ? = $259 500 + $230 000

$77 000 + ? = $489 500

? = $489 500 - $77 000 = $412 500 (value of land and buildings)

By applying the equation we can find the missing item. In general, whenever you see a balance sheet, it is wise to quickly do this equation to satisfy yourself that it is correctly drawn.

Summary

• The balance sheet should always balance.
• This means the assets must equal the liabilities.
• The balance sheet equation is: Assets = Liabilities + Owner's equity or A = L + OE.

Revision

1 Calculate the missing figure for each of the following:
   (a) Assets = $245 000, Liabilities = $43 000, Owner's equity = ?
   (b) Assets = $342 000, Owner's equity = $152 000, Liabilities = ?
   (c) Assets = ?, Liabilities = $63 000, Owner's equity = $212 500
2 Using the following balance sheet, calculate the value of the mortgage.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current assets</td>
<td>Current liabilities</td>
</tr>
<tr>
<td>Cash at bank</td>
<td>Creditors*</td>
</tr>
<tr>
<td>$7,000</td>
<td>$1,250</td>
</tr>
<tr>
<td>Debtors*</td>
<td>Bank overdraft</td>
</tr>
<tr>
<td>$3,400</td>
<td>$2,200</td>
</tr>
<tr>
<td>Stock</td>
<td>Credit cards</td>
</tr>
<tr>
<td>$11,000</td>
<td>$4,800</td>
</tr>
<tr>
<td>Non-current assets</td>
<td>Non-current liabilities</td>
</tr>
<tr>
<td>Land and buildings</td>
<td>Mortgage</td>
</tr>
<tr>
<td>$150,000</td>
<td>$?</td>
</tr>
<tr>
<td>Fixtures and fittings</td>
<td>Owner’s equity</td>
</tr>
<tr>
<td>$12,300</td>
<td>Owner’s capital</td>
</tr>
<tr>
<td></td>
<td>$35,000</td>
</tr>
</tbody>
</table>

*Note: Debtors are accounts receivable; creditors are accounts payable.

3 Calculate the total value of assets, owner’s equity and liabilities from the balance sheet.

4 If retained profits and owner’s capital totalled $23,000, instead of $35,000, calculate the new value of the mortgage.

5 An artist, Candice Wahler, has asked you to help her construct a balance sheet.
   (a) Briefly explain to her how a balance sheet is set out.
   (b) Construct a balance sheet for her as at today’s date from the following information:
       cash at bank $1,500, motor vehicle $10,000, accounts payable $6,000, equipment $8,200, accounts receivable $3,000, bank loan $13,500 and stock $3,000.

**Extension**

1 Goodwill is sometimes determined by the following two methods:
   - **method 1** — the difference between the total value of a business’s assets and the selling price of the business
   - **method 2** — a proportion (e.g. 20 per cent) of the average of the past three years’ trading profits.

**Application of method 1**
A business is offered for sale for $250,000, but the valuation of the assets and stock at cost is $200,000. Thus, the goodwill is $50,000. This reflects the good trading reputation of the business, the stable client base and stable supplier contracts.

**Application of method 2**
A business records the following profits in the years 2015–2017. Calculate its goodwill if goodwill is set at 40 per cent of the average three-year trading profits.

<table>
<thead>
<tr>
<th></th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net profit</td>
<td>$45,000</td>
<td>$65,000</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

Goodwill = ($45,000 + $65,000 + $50,000) × 0.40 = $160,000 × 0.40 = $64,000

Use the information below to determine the value of goodwill in the various scenarios provided:
(a) Ben’s Bowling is a business that is up for sale. The selling price is $150,000. The value of the assets totals $120,000.
(b) Leon’s Laser Toys has recorded annual profits for the last three years averaging $100,000. The goodwill calculation rate to apply is 33 per cent.
(c) Tina’s Video and Film Corporation has assets worth $40,000 in total. Profits are $3,000 annually on average, but she has put the business up for sale at $200,000. What should the goodwill be, assuming a goodwill calculation of 30 per cent of average profits over three years? What goodwill is Tina asking? Analyse the problems this raises for the valuation of intangible assets.

2 When a Qantas airline skidded off the end of the runway in Singapore, its perfect safety record was tarnished. No longer could it claim to be the ‘world’s safest airline’. Predict the effect this incident could have had on Qantas’s goodwill.
8.6 Human resources

Do you have a favourite ice-cream flavour? Chocolate? Vanilla? Trampoline Gelato is a rapidly expanding business, with more than a dozen franchises now operating. While they pride themselves on the uniqueness of their gelato, and have even won international awards, success in business requires more than just a great product. Each store has an ice-cream maker who makes the gelato daily to a consistently high standard, and cheerful, helpful sales assistants who promptly scoop out customers’ favourite flavours. Richard Furphy, CEO of Trampoline Gelato, says, ‘Great staff help get the best out of the product’. Employees can make or break a business, so the management of staff has to be top priority for every business owner.

Human resource management (HRM), in its simplest terms, is defined as the effective management of the formal relationship between the employer and the employees.

Successful business owners recognise that they rely on the quality of their employees to achieve their goals of improved profit, growth and increased market share. For a business to make best use of its employees, it should:

• take care to hire the best people
• develop cooperative and effective working relationships
• motivate staff to do their best in the workplace
• provide employees with opportunities for training and development.

Also, when an employee turns out to be an excellent worker, retaining that employee may be crucial to ongoing business success. Without dedicated, trained and motivated employees, the best organised plans will never be achieved. The human factor is crucial in all businesses.

Most businesses that are successful in the long term maintain a balance between concern for success (expansion or profit) and regard for their employees. Better work and employment relationships, therefore, begin with the business recruiting and selecting appropriate staff members (see the following Snapshot).
SNAPSHOT

• Selecting an employee that meets our expectations . . . is essential.

Bupa Health Dialog — a top employer

Brett Comer is General Manager of Bupa Health Dialog, located in Melbourne. Bupa Health Dialog offers evidence-based wellness, prevention and chronic disease management services to help meet the health needs of Australians.

In this interview, Brett outlines the recruitment and selection process the organisation uses.

What strategies do you use to employ the most suitable person?
I start with a well-defined job description, which outlines the requirements and challenges the role will encounter, and a job specification that details the key competencies I expect from that employee. I then provide a detailed brief to our HR team, which commences the recruitment process.

Do you prefer to recruit externally or internally?
Company policy is to recruit internally in order to provide employees with a career path, as well as to maintain a good cultural fit. If no suitable internal candidate is available, the HR team recruits externally using the internet and online recruitment agencies, such as SEEK, or newspaper advertisements. We will use an external recruitment agency if we need specialist support.

What is the next stage of the process?
After checking the resumes, the HR team will create a short list of candidates to interview. The interview panel usually consists of HR team members and the manager of the department requesting the position. The manager will be more interested in the technical aspects while the HR people look more for an appropriate cultural fit.

Why is assessing a candidate’s ‘cultural fit’ so important?
BUPA is a people services organisation that has strong internal teams. We deliver an external experience for our customers. Selecting an employee that meets our expectations, and who reflects our business culture, is essential. Our positive business culture is one of our main competitive advantages.

Do you use any testing instruments during the interview?
We use psychometric (psychological) testing for senior management positions or people working in specialist teams, such as our nurses. This tests factors such as intelligence, aptitude and personality characteristics.

What attributes do you want a candidate to possess?
Firstly, the technical abilities to perform the job. Secondly, somebody who displays the right set of values: caring, customer focused, accepts accountability, aspiration to develop and prepared to work in a team.

How do you attempt to overcome the present skills shortage when recruiting candidates?
One successful strategy, especially for nurse recruitment, is our Refer-a-Friend scheme, where employees can refer friends for a position. Should the referred person be successful, the employee receives $1000.

Snapshot questions
1. Outline what Brett Comer does prior to beginning the recruitment process.
2. Assess Bupa Health’s recruitment and selection process.
The main functions of staffing are to attract and acquire, train and develop, reward, maintain, and separate the people — the human resource/employment cycle — needed to achieve the business’s goals. It is crucial for all businesses to select employees whose business approach complements that of the business. How well these functions are managed will largely determine the success of any business. Once a person is selected for a position they must be ‘maintained’ in the workplace. Training and development, as well as ongoing feedback on work performance, will assist both the employer and employee. Separation (termination) of employment is the final phase of the human resource cycle; it must be managed to ensure employees are treated fairly and within the law.

The dynamic nature of business means that staffing needs will change over time. As the business expands, or existing employees resign or retire, new positions will be created, so business owners need to constantly monitor their staffing needs. However, at the heart of staffing is the employee. Hiring the ‘right’ person for the ‘right’ position is of crucial importance to all businesses.

The HSC course investigates human resources in greater depth, so this chapter will provide an elementary understanding of the main concepts.

**BizWORD**
The human resource/employment cycle covers all stages in the process of employing staff, from initial planning through to recruitment, selection, induction, training and development, performance management, and eventual separation of employment.

**BizFACT**
Gerry Harvey of successful retail chain Harvey Norman said, ‘Businesses are made by people. We’ve proven time and again that you can have a wonderful shop, and put a bloke in there who’s no good, and he’ll stuff it up. Put a good bloke in, and it just turns around like that.’

**FIGURE 8.40** It is important to hire the ‘right’ person for the ‘right’ position.

**Human resource cycle — the staffing process**
The human resource cycle involves a business determining its employment needs in line with its business strategy. As the name suggests, human resource management begins with acquisition — recruiting and selecting people to work for the business. Next, plans and procedures need to be put into place to train and develop these employees. As well, steps must be taken to keep — that is, maintain these valuable resources. Finally, there are times when employees will separate from the business, either voluntarily, through retirement or resignation, or involuntarily, through retrenchment or dismissal.

Figure 8.41 summarises the four main elements of the human resource cycle/staffing process: acquisition, development, maintenance and separation.
FIGURE 8.41 The four main elements of the human resource cycle/staffing process

Each of these elements consists of related activities (see table 8.5 below) that are carried out by the human resource department. Each of the four elements complements the other, with the desired outcome being a productive and efficient workforce.

TABLE 8.5 Elements of the human resource/staffing process and their related activities

<table>
<thead>
<tr>
<th>Phases of the human resource cycle/staffing process and their related activities</th>
<th>Element</th>
<th>Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stage one</td>
<td>Acquisition</td>
<td>• Hiring new employees</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Planning: identifying staffing needs; job analysis (determining the exact nature of the position to be filled)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Recruitment: attracting people to apply for the position in the business; internal and external recruitment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Selection: choosing and hiring the most qualified; testing and interviewing</td>
</tr>
<tr>
<td>Stage two</td>
<td>Development</td>
<td>• Improving employees’ skills and abilities</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Induction and training: teaching employees new skills and helping them learn tasks associated with their jobs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Development: the process of improving the skills, abilities and knowledge of staff</td>
</tr>
<tr>
<td>Stage three</td>
<td>Maintenance</td>
<td>• Motivating employees to remain with the business</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Monetary benefits: rewarding employees’ efforts through financial compensation; pay rates</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Non-monetary benefits: rewards such as conditions; fringe benefits</td>
</tr>
<tr>
<td>Stage four</td>
<td>Separation</td>
<td>• Employees leaving the business</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Voluntary: employees leaving on own accord; retirement, resignation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Involuntary: employees being asked to leave; retrenchment, dismissal</td>
</tr>
</tbody>
</table>
If handled correctly, ‘human resources’ can provide a business with a competitive advantage; if mishandled, this key area can generate many problems.

No longer can a business rely on a constant supply of homogeneous employees prepared to join a company for a lifetime. Businesses today must accommodate working parents with daycare needs, the middle-aged employee who has to care for an elderly parent or an increase in people from culturally diverse backgrounds.

Therefore, businesses today are taking their human resources function, especially the staffing process, more seriously than in the past.

Summary
- Employees are the most important resources for business success.
- Human resource management is the effective management of the formal relationship between the employer and the employee.
- Most successful businesses maintain a balance between concern for success and regard for their employees.
- The main functions of staffing are to attract and acquire, train and develop, reward, maintain and separate the people needed to achieve the business’s goals.

Revision
1. ‘People are the business’s most valuable resource.’ Outline what is meant by this statement.
2. Define the term ‘human resource management’.
3. Recall what a business should do to make the best use of its employees.
4. Identify the main functions of staffing.
5. Explain why good staff management is vital to a business’s success.
6. Identify the main functions of the staffing process.
7. Propose why the staffing process is referred to as a ‘human resource cycle’.
8. Construct a concept map summarising the four main elements and the related activities of the staffing process/human resource cycle.
9. Predict what problems can arise if a business employs a person unsuited to a particular position. Share your answer with the rest of the class.

Extension
1. Demonstrate the relationship between the human resource cycle and business goals.
2. Traditional human resource management (HRM) practices were developed and administered by the business’s human resource department. A recent study of HRM practices revealed that line managers — people responsible for the management of staff contributing to the main function of the business — are playing a greater role in developing and implementing human resource (HR) practices. Assess the value a line manager can bring to developing and implementing HR practices.
3. ‘The future is unpredictable. The business environment changes so rapidly that it is impractical to make relevant plans for future staffing requirements. HR plans are therefore largely irrelevant.’ Evaluate the accuracy of this statement.

Acquisition of human resources
The first stage of the human resource cycle is acquisition. Acquisition is the process of attracting and recruiting the right staff for roles in a business. Most people would associate this acquisition stage with the advertisement placed in the employment section of a newspaper or, increasingly, on an e-recruitment website.
However, before any advertisement is published, a business must undertake a number of planning activities. In a sense, the advertisement represents the end of the first activity (identifying staff needs) and the beginning of the next activity (recruitment).

As table 8.5 demonstrates, there are three distinct activities involved in the acquisition stage of the human resource cycle. The first is planning; that is, identifying staffing needs.

**Identifying staffing needs — human resource planning**

All businesses have to plan for the positions that inevitably become vacant in their organisations. Employees retire, resign, or are promoted. New positions develop as the business expands. Therefore, for most businesses, determining staffing needs is an ongoing process.

**Human resource planning** includes the development of strategies to meet the business’s future staffing needs, forecasting the future demand for employees and estimating the supply available to meet that demand.

If a business fails to accurately identify staffing needs and rushes to place a job advertisement in the hope of quickly hiring someone, then the stage is set for major problems. Usually, this results in a person being hired who does not possess the skills or attitudes required for the position. Therefore, it is crucial that all businesses undertake some human resource planning to accurately identify future staffing needs.

**BizWORD**

Human resource planning is the development of strategies to meet the business’s future staffing needs.

**Job analysis**: specifying staffing needs

Job analysis is the next step in forecasting a business's staffing needs. There is no sense in hiring people unless the business is clear about what it is hiring them to do. In other words, the business must determine the exact nature of a job before it can recruit the right person to do it. **Job analysis** is a systematic study of each employee’s duties, tasks and work environment.

**FIGURE 8.42** Employees represent a large investment and require as much planning as other resources.
Sonic Technologies
Better services, better performance

Trainee opportunity
Sonic Technologies has created an exciting trainee position for applicants with an interest in information communication technology and systems analysis. The successful candidate will be trained in the position to become a business systems analyst. This full-time position involves:

• coordination with both technical and non-technical staff to gather, assess and present data
• production of regular reports, plans and forecasts
• generation of creative solutions to fix problems and improve existing processes
• liaison with stakeholders to explore ongoing development of the business’s ICT systems.

Ideally, you must possess:

• graduate qualifications in business computing
• good administration skills
• strong analytical and problem-solving skills
• knowledge of IBM Notes
• knowledge of Windows 8.1 or Vista operating environments
• good communication skills
• the ability to work as part of a team.

Remuneration will be based on experience. Applications close Friday 19 June. Applications in writing should be addressed to: Manager, Sonic Technologies, PO Box 15, Glebe NSW 2037 E-mail: applications@sontech.next.com.au Phone: (02) 8096 4400

FIGURE 8.43  An example of a job description and a job specification

A job analysis examines:
• actual job activities
• equipment used on the job
• specific job behaviours required
• working conditions
• degree of supervision necessary.

The job analysis for a particular position typically consists of two parts:
1. Job description: a written statement describing the employee’s duties, tasks and responsibilities associated with the job (see figure 8.43).
2. Job specification: a list of the key qualifications needed to perform a particular job in terms of education, skills and experience (see figure 8.43).

Recruitment and selection
Once the job description and specification have been completed, it’s on to the process of recruitment and selection.

Recruitment
Recruitment involves finding and attracting the right people to apply for a job vacancy using advertisements, employment agencies and word of mouth. When an organisation decides to recruit staff, it may choose internal or external recruitment methods.

BizWORD
A job description is a written statement describing the employee’s duties, tasks and responsibilities associated with the job.

A job specification is a list of the key qualifications needed to perform a particular job in terms of education, skills and experience.

BizWORD
Recruitment is the process of finding and attracting the right quantity and quality of staff to apply for employment vacancies or anticipated vacancies.
Tourism Queensland recently advertised a six-month position for an island caretaker. It was advertised as the ‘best job in the world’ and attracted 34,000 applicants. It took four months to find the right person for the job, with the top applicants tested for a range of personal and communication skills. The successful applicant received rent-free accommodation and a salary package worth $150,000.

Internal recruitment occurs when a business decides to appoint someone already within the business to a vacancy. This usually involves an opportunity for a person to take on different duties, and can mean a promotion to take on greater responsibilities within the business. Internal recruitment is popular and involves less risk, because the employer already knows the person who will be filling the vacancy. Of course, the person recruited internally may then have to be replaced by external recruitment.

External recruitment is used to find suitable applicants from outside the business, because staff planning has identified the need for a new position, an existing employee has resigned or retired, or the person previously performing the duties has been transferred or promoted to a new position within the business.

The recruitment method chosen will depend on the size of the business, the type of position available and the nature of the labour force in the business’s particular area. The main sources of employees available to a business include:
- advertisements in the media
- private employment/recruitment agencies
- schools, TAFE colleges or universities
- government employment agencies — for example, Australian JobSearch
- internal searches
- online services
- temporary casual agencies
- word of mouth
- family members.

Most businesses will want to advertise as widely as possible to attract the greatest number of applicants, so they will often use more than one avenue. Many businesses use employment agencies to handle the recruitment of staff. Some agencies specialise in particular industries and will handle all the advertising of vacancies. This is an expensive, but effective, method — the agency does the preliminary screening of candidates and presents potential employees who fit all the criteria of experience, education and training (see the following Snapshot).
Many jobs are advertised online. Businesses, such as Seek Limited, provide an efficient way for job seekers to search online for jobs that meet their qualifications and expectations. Employers and recruiters use businesses like Seek to advertise positions online and therefore reach a wide audience, although some still choose the traditional method of advertising in the newspaper. Advertising in the general media means that a business has to screen applicants and then proceed with interviews. This is often time consuming if the business receives a large number of applications; however, it does prove effective in many cases and small to medium-sized businesses often use this method.

Recruitment — the outsourcing trend

Many small business owners use external recruitment agencies as a way of decreasing the time involved in searching for a new employee. They pay an agency to interview applicants and recommend a short list of potential employees or an employee suitable for the available position.

There are a number of reasons for this trend, including the:

- growing demands on business to comply with increasingly complex employment legislation. Small business owners find it beneficial to access specialist advice rather than risk breaching employment law.
- availability of online recruiters. Recent statistics show that small business employers have widely embraced e-recruitment agencies.
- desire by small business owners to concentrate on their core business.
- difficulty in attracting candidates due to the low level of unemployment. External recruiters generally have ready databases of possible employees and the skill to sort candidates.

However, the principal reason for using an e-recruitment agency is related to the cost of a poor recruitment decision, which is generally believed to be around two or three times the annual salary of the person recruited. A poor recruitment and selection...
A poor recruitment and selection process leads to increased costs and lower productivity.

Snapshot questions
1. Construct a concept map summarising the main reasons why businesses use recruitment agencies.
2. Explain the impact of a poor recruitment and selection process.

Selection

Employee selection is the means by which the employer chooses the most suitable applicant for a vacancy. This involves identifying the skills, qualifications and experience of each applicant, and relating them to the skills, qualifications and experience listed in the job specification, to achieve the closest possible match.

Selecting the most appropriate candidate can involve all or any of the following options:

- **Written application.** Some employers make use of a printed application form to be filled in by the applicant, requiring basic personal information, details of qualifications and experience, and names of referees. Alternatively, prospective employees may be able to submit a written application in any form they wish. This will usually include a *curriculum vitae* or *résumé* as well as any other relevant information. Applicants will often try to indicate how their own qualifications and experience match those included in the job specification. The employer usually shortlists a realistic number of suitable applicants.

**BizWORD**

Employee selection involves gathering information about each applicant for a position, then using that information to choose the most appropriate applicant.

*A curriculum vitae* or *résumé* is a summary of a person’s previous employment experience.

**FIGURE 8.46** Sometimes getting the job means showing what you can do at the interview. At auditions for the television program *So You Think You Can Dance*, this candidate will need to convince the judges that he has the dancing skills to enter the competition.
• **Testing.** Employers may apply a number of different tests to prospective employees. These can include psychological tests or personality tests, which attempt to measure an applicant’s personal characteristics; or aptitude tests, which attempt to measure the skills that might be relevant to the job description. Tests may be written, or may require the applicant to perform a number of different tasks.

• **Interviews.** The interview is perhaps the most important procedure in the selection process. Interviews should be well structured and cover a set of common questions to ensure consistency between applicants.

• **Background checks.** Referees can be contacted to verify the accuracy of an applicant’s previous experience, and to gain an assessment of their performance in a previous position.

After the successful applicant has been notified and has accepted the position, the other applicants are notified.

**Summary**

• Human resource planning involves developing strategies to meet the business’s future staffing needs.

• A job analysis is a systematic study of each employee’s duties, tasks and work environment. It comprises a job description and job specification.

• After the planning stage, the recruitment of staff commences to find the best person for the job.

• Recruitment involves finding and attracting the right people to apply for a job vacancy.

• A business can recruit from staff within the business or seek new applicants from outside sources.

• Once job applicants are found, the process of selecting the right applicant begins.

• Employee selection is the means by which the employer chooses the most suitable applicant for the vacancy.

**Revision**

1. **Outline** why determining staffing needs is an ongoing process.

2. In the following situations, **explain** whether staff planning has been adequate.
   - (a) Anya runs a small café that mainly sells cake and coffee. She decides to offer a lunch menu. It turns out to be very popular, but many customers have to be turned away because Anya cannot meet the demand.
   - (b) The restaurant is always busy over the Christmas period, so Jon decides to recruit some casual staff to ensure he is able to maintain an efficient service.
   - (c) Gregory knew that his existing workers would not have the skills to operate the new equipment he had purchased for his motor mechanic business. He employed someone with computer skills, with the aim of training the other workers as well.

3. **Explain** the relationship between a job analysis, a job description and a job specification.

4. In each of the following cases, the employer did not plan appropriately. For each example, **construct** a job specification that would have prevented the problem.
   - (a) Joanne wasn’t a qualified veterinary nurse, but the veterinary clinic employed her anyway because she loved animals. On most days, Joanne found difficulty doing simple bandaging and could not provide the advice expected of her.
   - (b) Carrie was a waiter in a restaurant. When customers came in she would ignore them until she had finished what she was doing and always suggested that tipping was expected.
   - (c) Janelle was employed as a florist but most of her bouquets fell apart when she handed them to the customer.

5. **Undertake** a job analysis for the position of ‘Year 11 Business Studies student’ at your school and **identify** the key elements for consideration.
6 Construct job advertisements for two of the following positions:
(a) music store sales assistant
(b) accountant
(c) motor mechanic
(d) motel receptionist.
Remember to include the job description and the job specification in your advertisement.

7 Summarise the two activities in the employment process: recruitment and selection.

8 Distinguish between internal recruiting and external recruiting.

9 In small groups, identify the advantages and disadvantages of internal and external recruitment.

10 In small groups, prepare a table of all the recruitment methods with which you are familiar. For each method, identify an associated strength and weakness. The first one has been completed for you in the table below.

<table>
<thead>
<tr>
<th>Recruitment method</th>
<th>Strength</th>
<th>Weakness</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal advertising</td>
<td>Quick and inexpensive</td>
<td>Draws from existing employees only</td>
</tr>
</tbody>
</table>

11 Select three sources of employees available to a business and propose why each is an effective method of recruitment.

12 Describe two options that can be used in the selection process.

13 ‘In the current business environment it is crucial that small business owners recruit and maintain the right people for the job.’ In small groups, discuss the relationship between good staff and business success.

**Extension**

1 Predict the problems that may arise if a small business does not undertake human resource planning in some form. Give examples from small businesses with which you are familiar or that you have studied.

2 Determine how a business’s recruiting and selection practices may be affected by the type of position that has to be filled (i.e. a part-time sales assistant compared to a chief executive officer for a large transnational corporation).

3 You have recently been appointed as human resource manager for a national clothing company. The business has a history of high staff turnover and low morale. To correct these problems you have decided to improve the recruitment and selection procedures. Propose the steps you might take to identify capable employees. Determine how you would screen applicants.

4 Use the Job interview weblink in your eBookPLUS to examine the tips and advice on how to prepare for a job interview. In small groups, think of a job you are familiar with and construct possible interview questions. Select one person to adopt the role of a human resource manager. Each of the remaining people in the group will become possible candidates for the job. They will need to prepare for the interview and then the human resource manager is to conduct interviews with each person. During the interviews, the remaining members are to act as observers and provide feedback to each candidate.

5 Use the SEEK weblink in your eBookPLUS to find hints for applicants preparing for and attending an interview. Create a poster that contains hints for applicants to assist them to succeed at an interview.

**Training and development**

Training and development are aimed at improving employees’ skills and abilities — they are necessary for both personal and business growth. New employees may need some training and development, depending on their level of experience. Existing employees also need training and development to continually upgrade
their skills. **Training** is teaching staff to perform their job more efficiently and effectively by boosting their knowledge and skills. **Development** is the process of preparing employees to take on more responsibilities in the future through acquiring better knowledge and skills, and gaining more experience in a particular area. Developing staff often involves training. It is interesting to note that many employees expect their business to provide them with opportunities to grow and learn, and ultimately improve their employability.

The aim of training and development is to seek long-term change in employees’ skills, knowledge, attitudes and behaviour in order to improve work performance in the business. Many businesses do not, however, spend enough on staff training. According to the Australian Centre for Industrial Relations Research and Training, there is little evidence of a strong training culture within Australian workforces. This is unfortunate because a lack of training and development can have long-term implications for a business’s ongoing competitiveness, and could lead to higher turnover rates as staff seek development in other forms. Well-organised and well-presented training and development provides benefits for both the employee and the employer (see table 8.6 below).

---

**BizWORD**

Training generally refers to the process of teaching staff how to perform their job more efficiently and effectively by boosting their knowledge and skills.

Development refers to activities that prepare staff to take greater responsibility in the future.

**BizFACT**

Ford Australia claims that employee training has led to halving absenteeism and reducing labour turnover. Can you account for this relationship?

---

**TABLE 8.6** Training and development provide benefits for both the employee and the employer

<table>
<thead>
<tr>
<th>Benefits for the employee</th>
<th>Benefits for the employer</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Opportunity for promotion and self-improvement</td>
<td>• Higher productivity through better job performance and more efficient use of human resources</td>
</tr>
<tr>
<td>• Improved job satisfaction through better job performance</td>
<td>• Goals and objectives more effectively met</td>
</tr>
<tr>
<td>• A challenge — the chance to learn new things</td>
<td>• Reduced costs due to less labour turnover, errors, accidents, absenteeism</td>
</tr>
<tr>
<td>• Adaptability — greater ability to adapt to and cope with changes</td>
<td>• A more capable, ‘mobile’ workforce</td>
</tr>
<tr>
<td>• Improved chances of future employability</td>
<td>• Existing staff more easily retained</td>
</tr>
<tr>
<td></td>
<td>• Less disruption in the event of staff turnover</td>
</tr>
<tr>
<td></td>
<td>• An ‘insurance policy’ — employees are able to cope better with business ‘crises’ (this is a benefit for employees as well)</td>
</tr>
</tbody>
</table>

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**FIGURE 8.47** Life is a continual learning curve and it just doesn’t stop when you’ve completed your HSC. You may start a full-time job or you might go to TAFE or university. In any case, you will receive training to help you gain knowledge and learn skills to work productively.
An effective training and development program is planned and perceived as integral to the business’s strategy, as well as to maintaining or developing a business’s sustainable competitive advantage. Ongoing training for all employees is becoming critical due to rapid technological change and global competition — it is so critical that many businesses now promote the concept of a *learning organisation*. A learning organisation is aware of its actions and its environment and tries to improve its understanding of the relationship between the two. All employees are involved in developing knowledge and insights that allow the business to continually grow and improve.

**Technology creates the need for ongoing training**

It is the task of the human resource manager to plan for the effective introduction of new technology. Training needs must be identified well in advance of any proposed technological implementation. This will ensure change happens at a pace consistent with the capabilities and expectations of the workforce. It also means human resource managers must constantly consider the skills required by the workforce in the future. The existing workforce must be trained and, if very rapid technological change demands it, retrained within a short time. While training of employees is often expensive, it cannot be ignored.

**FIGURE 8.48** Most major hospitals are integrating advanced technology into their operations and this has required training for all employees.

**Types of training**

A number of training methods are available to businesses. The most common of these include:

- Formal off-the-job training — for example, classroom activities, simulations
- Informal on-the-job training — for example, coaching, job rotation
- Action learning: learning by experience solving real workplace problems — for example, NAB and IBM use this form of training
- Competency-based training: identifies skill strengths and areas where further training is required — for example, medical education uses this form of training.
• Corporate universities: businesses can also form partnerships with academic institutions to develop training — for example, Coles and Qantas have forged partnerships with academic institutions.

• Training technologies — for example, computer-based training (the computer becomes a vehicle for learning), multimedia training, web-based training (training via the internet).

Regardless of the type of training, business owners should view training and development as an investment in the human capital of the business, rather than just another expense (see the following Snapshot).

Motorola — an emphasis on training

Training at the communications company Motorola is high on the agenda. For nearly eight decades they have been recognised as one of the best employee training companies in the world.

Motorola placed a great emphasis on training from its inception in 1928. In the beginning, training simply involved teaching new employees how to use the manufacturing equipment. After conducting various training programs over a few decades, Motorola came to understand that training involves more than implementing one particular program for a set of employees. They came to realise that in order to keep improving performance, training should be a continuous learning process involving everyone in the business.

In the 1980s, the company set up the Motorola Training and Education Center, an exclusive institute dedicated to the training and development requirements of all Motorola employees. In 1989, this institute was elevated to the status of a university — Motorola University. The training programs provided became so successful that employee productivity and performance improved year after year, as did the quality of their products. The aim of having their own university was to provide education relevant to the company, job and individual. Motorola therefore developed their own courses designed to achieve those aims. Every Motorola employee must complete at least 40 hours of training a year.

Ten years after they began the university, Motorola reduced costs by US$10 billion and increased productivity by 139 per cent. Motorola calculated that in the departments where staff underwent this intensive training, the company was getting a return of nearly US$30 in three years for every dollar they invested on education and training.

Snapshot question

Explain the benefits of Motorola’s training initiatives.

Summary

• Training provides employees with the right knowledge and skills to perform their job effectively and efficiently.
• Development focuses on preparing the employee to take on more responsibilities within the business in the future.

SNAPSHOT

• Training at the communications company Motorola is high on the agenda.
• Ongoing training for all employees can be promoted by the business becoming a learning organisation.
• Training needs must be identified well in advance of any proposed technological implementation.
• Training should be viewed as an investment in the human capital of the business.

Revison
1 Identify the overall aim of training and development.
2 Distinguish between training and development
3 Propose reasons why you think ‘There is little evidence of a strong training culture within Australian workforces’. Share you answer with the rest of the class.
4 Outline how training and development can benefit both the employee and the employer.
5 Distinguish between informal on-the-job training and formal off-the-job training.
6 Explain why training and development expenses should be seen as an investment and not just a business expense.

Employment contracts
When a job applicant accepts an offer from an employer, a contract is established between the two parties. An employment contract is a legally binding, formal agreement between an employer and an employee.

An employment contract creates obligations for both employer and employee. All businesses operate within a legal framework of common law and statute law.

Common law
The common law is developed by courts and tribunals. Under common law, judges make decisions based on the facts of a case, guided by precedent (decisions made in the past). The body of common law is therefore developed from decisions made over time by judges.

Under common law, both employers and employees have basic rights and obligations in any employment relationship. Figure 8.49 summarises the employer and employee obligations.
Minimum employment standards

Employees are entitled to a set of minimum employment conditions, known as the National Employment Standards. These were legislated by the federal government in 2010 and apply to all full-time and part-time employees, whether permanent or fixed-term. They generally do not apply to casual employees. The 10 standards are:

• **Hours of work** — for full-time employees, this is generally set at between 35 and 38 hours per week. Employees cannot be required to work longer hours without special provision being made for penalty rates or other compensation.

• **Parental leave** — employees are entitled to 12 months unpaid parental leave in relation to the birth or adoption of a child.

• **Flexible work for parents** — an employee who is a parent of, or has caring responsibilities for, a child under school age will be entitled to request flexible working arrangements after having worked for the same employer for more than 12 months. These could include reduced hours, different start or finish times or home-working arrangements.

• **Annual leave** — for most employees this is four weeks, with part-time employees entitled to a pro rata amount. Casual employees have no entitlement to annual leave.

**BizFACT**

After the Howard federal government’s WorkChoices legislation in 2006, trade unions and other critics argued that many low-income earners and small business employees were adversely affected. For example, workers were losing conditions at work, penalty rates and overtime were being taken away, and they could be unfairly dismissed, with little remedial action available.

It was a key factor in the defeat of that government in 2007 and the incoming Labor government repealed the legislation. The Fair Work Act in 2010 restored a fair and equitable safety net of minimum standards of employment for all workers.
• **Personal, carer’s and compassionate leave** — full-time employees receive 10 days paid personal and carer’s leave for every year of service with the organisation, with part-time employees receiving a pro rata amount.

• **Community service leave** — this includes jury service and emergency service duties, such as CFA or SES volunteer work. Employees are entitled to be absent from work for all periods necessary to provide the community service, including reasonable travelling time and rest time immediately after the activity. Usually this is unpaid leave, although employees on jury service leave can claim make-up pay.

• **Public holidays** — employees are not required to work on public holidays, but will still be paid for the hours they would have worked. If the employer requests the employee to work on a public holiday, the employee may be entitled to a penalty rate or other compensation.

• **Information in the workplace** — employers are required to supply all employees with a ‘Fair work information statement’ when they commence employment. This is a government document which contains information about the National Employment Standards and other employment related issues.

• **Notice of termination and redundancy** — most employees are entitled to minimum periods of notice of termination of their employment (or pay in lieu of notice), based on their period of continuous service. Fixed-term and casual employees, and employees serving a probationary period of employment, are not included.

• **Long service leave** — permanent employees, whether full time or part time, are entitled to long service leave after a qualifying period. This period varies between different occupations and industries.

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**BizWORD**

An **award** is a legally binding agreement that sets out the minimum wages and conditions for a group of employees.

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**Awards**

An **award** is a legally binding agreement that sets out the minimum wages and conditions for a group of employees. Modern awards came into effect on 1 January 2010. The ten matters that can be included in modern awards are listed in table 8.7.
Some businesses will provide above-award payments, especially if they wish to attract more workers to their firm or if they want to hold on to their existing staff. Awards have the following advantages:

- set a minimum for pay and conditions
- cover all employees performing a similar job

Awards have the following disadvantages:

- can be inflexible and therefore may not suit all employees or businesses
- prevent recognition of individual initiative because all employees are guaranteed the minimum pay and conditions regardless of how productive they are.

**TABLE 8.7** Matters covered by awards

<table>
<thead>
<tr>
<th>The 10 matters that can be included in modern awards</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Minimum wages, including disability and training wages</td>
</tr>
<tr>
<td>2. Types of employment, such as full-time, part-time, outworker</td>
</tr>
<tr>
<td>3. Arrangements for the hours during which work is performed</td>
</tr>
<tr>
<td>4. Overtime rates where applicable</td>
</tr>
<tr>
<td>5. Penalty rates</td>
</tr>
<tr>
<td>6. Annualised wages and salaries</td>
</tr>
<tr>
<td>7. Allowances</td>
</tr>
<tr>
<td>8. Details of leave, leave loading, etc.</td>
</tr>
<tr>
<td>9. Superannuation arrangements</td>
</tr>
<tr>
<td>10. Procedures for consultation, representation and dispute settlement</td>
</tr>
</tbody>
</table>

**Enterprise agreements**

Imagine all the students in your Business Studies class sitting down with your teacher and negotiating a set of conditions for your class. Apart from the essential conditions, such as completing all the work and respecting each other’s opinions, you might negotiate a homework-free month in return for one extra assessment task. You have just entered into an enterprise agreement.

**Enterprise agreements** are collective agreements made at a workplace level between an employer and a union, acting on behalf of its employees, or between the employer and a group of employees, about terms and conditions of employment. In addition to the 10 National Employment Standards, enterprise agreements must include the following:

- a nominal expiry date, usually two or three years after the commencement of the agreement
- procedures for settling any disputes that might arise in the implementation of the agreement, including the right of employees to be represented in the dispute settlement procedure
- terms that allow for individual flexibility, so that arrangements can be made between the employer and individual employees
- provisions for consultation with employees on major workplace change.

Once the parties to an enterprise agreement have concluded their negotiations the agreement needs to be submitted to the Fair Work Commission for approval before it can commence operation. The agreement must be signed by the employer and the bargaining representatives acting on behalf of employees, to certify that the agreement has been entered into voluntarily by both sides. The Fair Work Commission will examine the detail of the agreement to ensure no unlawful content is included in the agreement and that the employees will be better off overall by entering into the agreement than simply being covered by the relevant award.

**BizWORD**

**Enterprise agreements** are collective agreements made at a workplace level between an employer and a union, acting on behalf of its employees, or between the employer and a group of employees, about terms and conditions of employment.

**BizFACT**

Modern awards are new and streamlined and created to replace thousands of existing awards. The new awards apply to many employees and employers in the national workplace relations system. For example, the security industry will see a reduction from 10 security awards to just one national security award.
FIGURE 8.51 The Fair Work Commission is the national workplace relations tribunal. It has the power to carry out a range of functions including providing a safety net of minimum conditions in awards, resolving workplace disputes and facilitating good faith bargaining and the making of enterprise agreements.

Enterprise agreements have the following advantages:
- consultation with and involvement of employees, which, if conducted successfully, results in greater employee involvement and empowerment
- possibility of improved pay and conditions, which can be tied to workplace performance
- greater flexibility by agreeing on conditions that suit both the employer and employee.

Enterprise agreements have the following disadvantages:
- more time consuming due to the need to conduct agreement meetings at the individual workplace level
- administratively more onerous, especially as the agreement must comply with all existing laws regarding employee rights and entitlements.

FIGURE 8.52 A more decentralised system of employee relations means that employers and employees negotiate on a local level through collective or individual agreements. This also means that wages and work conditions are determined through a bargaining process at the enterprise (workplace) level.
Summary

• An employment contract is a legally binding, formal agreement between an employer and an employee.
• Under common law, both employers and employees have basic rights and obligations in any employment relationship.
• Employees are entitled to 10 minimum employment conditions, known as the National Employment Standards.
• An award is a legally binding agreement that sets out the minimum wages and conditions for a group of employees.
• Enterprise agreements are collective agreements made at a workplace level between an employer and a union, acting on behalf of its employees, or between the employer and a group of employees, about terms and conditions of employment.

Revision

1 Define the term ‘employment contract’.
2 Examine the BizFact on page 262. Explain what is meant by the saying ‘verbal contracts are not worth the paper they’re written on’.
3 Recall the obligations of both employers and employees.
4 Identify which categories of employees are entitled to benefit from the 10 National Employment Standards.
5 Select what you consider to be the three most important standards from the 10 National Employment Standards. Justify your selection.
6 Define the term ‘award’.
7 Recall four of the ten matters that can be included in modern awards.
8 Distinguish between awards and enterprise agreements.
9 Select whether you would prefer to be covered by an award or an enterprise agreement. Justify your selection.

Extension

1 Use the Fair Work Commission weblink in your eBookPLUS to find the modern Award relevant to the retail or hospitality industry, or any other industry in which you or your classmates have part-time employment. Outline the key matters that are covered by this Award.
2 Investigate workplace relations issues for young people by using the Young people at work and NSW Office of Industrial Relations weblinks in your eBookPLUS. Select a topic that interests you and create a brief report on what you learned.

Separation of human resources

Gone are the days when a person would commence their full-time working life at the age of 16 or 17, work for approximately 45 years, and then retire. Work patterns and business operations have undergone radical change over the past two decades and this has dramatically altered the movement of people into and out of jobs. Due to increased international competition, many businesses — large, medium and small — have been forced to restructure. As a result, there has been a marked increase in the number of voluntary and involuntary redundancies being offered.

Separation is the ending of the employment relationship. There are many reasons why employees separate from a business. However, it is possible to classify the different types of separation into two broad categories: voluntary and involuntary (see figure 8.53).
**BizWORD**

**Voluntary separation** occurs when an employee chooses to leave the business of their own free will.

**Retirement** occurs when an employee decides to give up full-time or part-time work and no longer be part of the labour force.

**Resignation** is the voluntary ending of employment by the employee ‘quitting’ their job.

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**Voluntary separation** occurs when an employee chooses to leave the business of their own free will. There are three different forms of voluntary separation: retirement, resignation and redundancy.

**Retirement**

Retirement occurs when an employee decides to give up full-time or part-time work and no longer be part of the labour force. Until the mid 1980s, it was common for men to retire once they reached 65 years of age and women 60. Since changes to legislation in the 1990s there is now no ‘official’ retirement age. People now have a choice at what age they would like to retire. A trend that has started to emerge in recent years is for people to retire ‘early’ — that is, in their mid to late fifties. How businesses have approached employee retirement has also changed. Today, many organisations provide advice and assistance to employees to help them prepare for retirement.

**Resignation**

Resignation, or ‘quitting’, is a voluntary ending of the employment relationship. People resign for a variety of reasons including:

- offer of a promotion with another business
- to start their own business
- boredom with their present job
- change of lifestyle.

Usually the employee needs to give the employer sufficient notice of his or her intention to resign. The length of notice varies from job to job, ranging from a few hours for casual employees to a month for some permanent employees.

Whenever a business wants to downsize, that is decrease the size of its operation, it will not fill vacancies that have come about due to retirements and resignations.
Redundancy — voluntary and involuntary

**Redundancy** is when a particular job a person is doing is no longer required to be performed, usually due to technological changes, a merger or acquisition. Therefore, unless the existing employee can be retrained for another job, they will be made redundant. Redundancy can be either voluntary or involuntary.

Voluntary redundancy occurs when the business wishes to reduce either the size or nature of its workforce and decides how many employees should be ‘let go’. Employees are then informed of the situation and given the opportunity to nominate themselves for voluntary redundancy. Employees who choose voluntary redundancy are offered a redundancy package: a payout of a sum of money. If not enough employees volunteer, then the business may be forced to decide which employees will be made redundant — involuntary redundancy.

**Involuntary separation**

**Involuntary separation** occurs when an employee is asked to leave the business against his or her will. Apart from involuntary redundancy, the two different types of involuntary separation are retrenchment and dismissal.

**Retrenchment**

**Retrenchment** is sometimes called redundancy, but there is a subtle difference between the two terms. Redundancy occurs due to the permanent elimination of some jobs, because organisational or technological change has removed the need for those particular skills. Retrenchment is employee termination due to lack of sufficient work to keep the employee fully occupied.

Retrenchment is a cyclical phenomenon tied closely to the level of economic activity. The end result of both retrenchment and redundancy is that the employee is out of a job.

**Dismissal**

There will be occasions when the behaviour of an employee is unacceptable and it then becomes necessary for a business to terminate the employment contract of an employee. This is called **dismissal**.

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**BizWORD**

**Redundancy** occurs when a person’s job no longer exists, usually due to technological changes, an organisational restructure or a merger or acquisition.

**BizWORD**

**Involuntary separation** occurs when an employee is asked to leave the business against their will.

**Retrenchment** is when a business dismisses an employee because there is not enough work to justify paying him or her.

**BizWORD**

A **dismissal** is when the behaviour of an employee is unacceptable and it then becomes necessary for a business to terminate the employee’s employment contract.
The most serious form of dismissal is summary dismissal — when an employee commits a serious breach of their employment contract. For example, an employee who is drunk at work or is found to have engaged in criminal activity may be summarily dismissed. If an employee is given a summary dismissal, no notice is required. Another form of dismissal, referred to as dismissal on notice, is when an employee is not performing the job satisfactorily. Poor performance may be identified during an appraisal or performance process. The amount of notice (or payment given in lieu of notice) will vary depending on a number of factors, such as whether the employee is governed by a particular award or contract, the age of the employee and how long they have worked for the employer on a continual basis.

Selecting staff for dismissal can be risky and requires awareness of legislation and industrial agreements to avoid litigation and industrial action. Employees must be given proper notice and employers must comply with procedures established in law, including the unfair dismissal laws in the Fair Work Act 2009. To avoid misunderstandings, written warnings and/or notice is preferable. Written confirmation of resignation is also preferable to verbal statements made in the ‘heat of the moment’. This way, a lengthy unfair dismissal case can be avoided.

Unfair dismissal occurs when an employer dismisses an employee for discriminatory reasons. This is an issue that both employers and human resource managers need to be aware of. Some examples of discrimination under Commonwealth workplace relations laws include dismissal because of:

- absence from work due to illness
- either belonging or not belonging to a trade union
- race, colour, sex, sexual preference, age, disability, marital status, family responsibilities, pregnancy, religion, political opinions held or ethnicity.

An employee who believes they have been unfairly dismissed may lodge an unfair dismissal claim with an industrial tribunal.

**BizFACT**

Unfair dismissal laws allow employees to sue their employer on the grounds that their dismissal was harsh, unjust or unreasonable.

**SNAPSHOT**

Unfair dismissal — bullying claims not investigated

Failure to investigate allegations of bullying was a key issue in the recent unfair dismissal case of *Adam James Harley v. Aristocrat Technologies Australia Pty Ltd* [2010] FWA 62. In this case, Mr Harley successfully argued that he was constructively dismissed from his sales role having received a ‘show cause’ letter from the company and being required to attend a meeting with management to respond to allegations of alleged poor performance.
The Fair Work Commission found that Mr Harley had been subjected to a course of harassment by his manager, which culminated in the company’s attempt to terminate his employment. Despite Mr Harley making complaints about his manager’s constant criticisms, the company did not take the complaints seriously and did not investigate the complaints.

The Fair Work Commission found that the applicant had been unfairly dismissed and awarded the maximum of six months’ compensation to Mr Harley. The Fair Work Commission was particularly critical of the company’s human resources department for failing to investigate the matter, despite being a large multinational company with ample resources, including a dedicated human resources team.


Snapshot question
Do you agree with the decision of the Fair Work Commission? Justify your answer.

Summary
• The final stage in the employment cycle is the ‘separation stage’, in which employees leave the workplace on a voluntary or involuntary basis.
• This stage must be handled carefully and sensitively by the human resource manager.
• Voluntary separation occurs when an employee decides to give up full-time or part-time work and includes:
  – retirement
  – resignation
  – redundancy.
• Involuntary separation occurs when an employee is asked to leave the business against their will and includes:
  – retrenchment
  – dismissal
  – redundancy.
• Unfair dismissal occurs when an employer dismisses an employee for discriminatory reasons.

Revision
1 Distinguish between voluntary and involuntary separation, giving examples of each.
2 Construct a concept map outlining the different types of voluntary and involuntary separation.
3 Recall some of the entitlements of employees who are made redundant.
4 Distinguish between summary dismissal and dismissal on notice.
5 Identify which of the following scenarios would most likely lead to summary dismissal.
   (a) Todd bribed another employee not to tell their manager that he had been accessing pornographic websites during office hours.
   (b) Roberto arrives for work entirely drunk. He has just been out to see a client, driving a company car. It’s the third time this week he has arrived in such a condition.
   (c) Jazmin’s not very good at her job. She frequently makes mistakes and doesn’t have the knowledge or skills to perform the job satisfactorily.
Recall three dismissal situations that would be classified as unfair.

In August 2008, workers at SPC Ardmona in the Goulburn Valley were informed that 60 redundancies were to occur, because the strong Australian dollar had meant a drop in exports and there was a fruit shortage due to the drought. The company employed 450 workers in three plants in the region. SPC Ardmona’s chief executive, Nigel Garrard, said that initially the redundancies would be voluntary and workers would be offered deployment to different sites.

(a) Explain what Nigel Garrard meant when he said that initially redundancies would be voluntary.

(b) Predict the possible impact on staff who volunteer for redundancy and those who remain. Share your answer with the rest of the class.

Use the Termination of employment weblink in your eBookPLUS to summarise the latest employee rights and rules that apply to termination of employment.

**Extension**

1 Compare voluntary and involuntary departures in terms of:
   (a) how difficult each is for the business
   (b) effects on the business
   (c) effects on staff leaving
   (d) effects on staff remaining.

2 Termination management is about managing the final phase of the employment cycle, when the employee leaves. Investigate the issues a HR manager must be aware of when dismissing an employee.

3 Read about the following case and then answer the questions.

Natashia Frazer and Civic Printers

I had been employed by Civic Printers for 12 years. One month ago, my new supervisor warned me that if my work did not improve I may be dismissed. Prior to this I had only received favourable work reports.

One Friday afternoon I was told that someone else had complained about my performance and that I was being dismissed. I was not aware of any other complaint. I had never been given any written advice that my work was unsatisfactory. However, the supervisor’s decision was final and I was dismissed. I think it is unfair.

(a) After reading the story have a class vote to determine whether Natashia’s dismissal was fair or unfair.

(b) Now divide the class into small groups. Each group has to determine whether the termination of Natashia was fair or unfair, and then report back to the class. Discuss the different group responses.

(c) Take another vote to see if the discussion has made any difference to class members’ views.

(d) Synthesise what you learnt from this activity.

**8.7 Ethical business behaviour**

Ethics are standards that define what is acceptable and unacceptable behaviour. Ethics involves the study of moral issues and choices. It is concerned not with legal obligations but with what is morally right or wrong — and all the shades of grey in between. In many decisions involving ethical questions, it is sometimes difficult to give a definitive answer as to what is ‘right’ and what is ‘wrong’. It often depends upon the individual circumstances surrounding the situation. Business ethics is the application of moral standards to business behaviour.

Most businesses want to engage in ethical business practices; to act honestly and morally. These businesses will honour commitments, not engage in misleading or deceptive product descriptions and will provide a safe working environment for their employees.

BizWORD

Business ethics is the application of moral standards to business behaviour.
Not all businesses have adopted such an outlook. Some business owners still regard ethical business practices as a waste of money, the cost outweighing any benefits. They will often attempt to justify their behaviour as ‘smart business practice’ or ‘everyone does it, why shouldn’t I?’ And like most questions of ethical behaviour, not all the answers are a simple ‘black’ or ‘white’ response.

### Australia’s rag trade — a question of ethics

Think twice before buying Australian made, writes Rachel Wagner. That jacket might have been made for $5 in a backyard sweatshop.

The phrase ‘unethically produced clothing’ usually conjures images of sweatshops in China, with workers packed shoulder-to-shoulder, labouring long hours for a pittance.

Unfortunately, the reality on our own shores is almost as sordid.

Australia’s rag trade is littered with the underpaid and the overworked. These people are known as ‘outworkers’ and they are among Australia’s lowest paid employees.

According to the Textile Clothing and Footwear Union of Australia, approximately 50–70% of Australian made clothing is outsourced to migrant women working from home or in backyard sweatshops…

Accreditation Advisor for Ethical Clothing Australia, Rebekka Carey-Smith, said it really is a case of ‘out of sight, out of mind’.

Outworkers generally work in isolation, prevented from conferring with peers about their absent rights. They are inundated with high volumes of clothing to sew on tight or even unattainable deadlines.

Those who don’t speak English are even more vulnerable to exploitation:

‘Some people, unfortunately mainly migrant women, work up to 17 hours a day earning as little as $5 an hour’, said Carey-Smith. ‘They don’t know what rights they are entitled to.’

Legally, in addition to award wages, outworkers are entitled to all the benefits that employees are afforded, such as superannuation, sick leave and insurance, yet most receive none of these basic prerogatives. Instead, they are rewarded with a towering pile of fabric and a back injury for all their hard work.

It may seem like a dire situation, but it’s easy to see how it could happen.

With fashion labels contending for the market share, production costs are routinely cut to be competitive and offer the most affordable clothing. Quality and sustainability fall by the wayside when it comes to fast fashion.

While outsourcing to sweatshops abroad may seem like the most lucrative avenue, locally made clothing can be both affordable and convenient. It means there are no long trips to oversee production, and shipping costs are greatly reduced.

‘Manufacturing onshore really is a viable option because it means you are in complete control of production’, said Carey-Smith.

With fashion houses able to produce their stock locally at such a low cost, ‘Australian Made’ is no longer synonymous with ethical clothing.

As you move down the supply chain, it can be hard to point the finger at a culprit. Production work is outsourced to companies who then delegate tasks to outworkers. Many high profile companies aren’t even aware of the transgressions at the other end of the chain.

Until the big brands are held accountable, the ‘Australian Made’ label will continue to lose value. Yes, it is great to support local businesses, but how much pride can we bestow on unethical products?

The kneejerk reaction is to suggest a boycott of all brands that lack a transparent supply chain. Alas, this only leads to redundancy for the very people it aims to protect.

(continued)
‘It’s more important to educate the companies about what they need to do to ensure their employees are getting paid enough and are working in ethical conditions’, said Carey-Smith.

In the wake of the issue, the slow fashion movement is gaining momentum in Australia. The antithesis to the sleazy world of fast fashion, it endeavours to create a resistance to consumerism by encouraging shoppers to be more mindful about their purchases.

If this can generate a surge of support for accredited ethical labels, the Australian fashion industry may be able to salvage its tarnished reputation by promoting a culture of integrity and respect.

And of course, the outworkers might even get a raise.

Source: 8 April 2013, upstart.net.au.

**Snapshot questions**

1. **State** the percentage of Australian-made clothing outsourced to ‘outworkers’.
2. **Describe** the conditions under which outworkers work. **Analyse** the ethics of such conditions.
3. **Explain** why manufacturing onshore can be a viable option for Australian clothing companies.
4. **Discuss** why boycotting brands that use unethical practices might be problematic.
5. **Evaluate** how the ‘slow fashion movement’ might reduce the unethical manufacturing methods of some companies.

Some businesses have become involved in lengthy and very expensive court cases, which attempt to resolve particular situations that are often centred around a number of ethical issues or socially responsible actions. This frequently results in a deal of negative publicity and a deterioration in the business’s reputation.

**FIGURE 8.57** In 2010, retail giant David Jones was under the media spotlight for all the wrong reasons. The former CEO of the company, Mark McInnes, faced a $37 million sexual harassment charge when ex-employee Kristy Fraser-Kirk accused him of making inappropriate sexual advances towards her. The matter was eventually settled out of court for $850,000, and McInnes lost his job. Fraser-Kirk was suing her employer David Jones Limited as well as McInnes. She claimed that the senior management of David Jones were aware of the incidents and did nothing. David Jones was forced to review its complaints handling policies and procedures, to ensure that employees felt confident that their claims would be handled correctly.
The majority of business owners, however, regard the cost of ethically and socially responsible actions as a necessary expense — they make such a commitment an essential part of their business operation. They take a great deal of pride in the reputation their business has established and wish to protect its good name. These businesses want to be seen as responsible corporate citizens, conscious of the high standards expected of them by their customers and society at large.

Businesses that take their social and ethical responsibilities seriously are often ‘rewarded’ with improved business performance. Many businesses today are very much concerned with reporting on the triple bottom line. This means that they are no longer simply focused on making a profit at all costs; but rather, they recognise that environmental and social performance are also important.

A growing number of small businesses today, such as Etiko, exist purely for socially responsible and ethical reasons. Etiko is a small business based in Ferntree Gully, Victoria, with a strong commitment to ethics and the environment. Etiko sources products from international suppliers who produce Fairtrade certified items and/or are sweatshop free.

The founder of Etiko, Nick Savaidis, believes that ‘truly socially responsible businesses should not only minimise harm but actually make a positive contribution’. Beginning work as a secondary school teacher and then as an adult educator specialising in enterprise development in Northern Territory Aboriginal communities, Nick established ESP Pty Ltd (the company behind the Etiko brand) in 1996 to market ethically and environmentally sound products. While consumers purchase its products, Etiko is able to help fund community development, micro-credit and healthcare programs around the world. It is no coincidence that it has won many awards in the area of ethics and social responsibility.

**BizWORD**

*Triple bottom line* refers to the economic, environmental and social performance of a business. *Fairtrade* is a trading partnership that seeks greater equity (fairness) in international trade. It promotes the rights of marginalised workers, especially in low-income countries.

**FIGURE 8.59** FareShare is a small, not-for-profit business that is based on social responsibility. They give away healthy, nutritious meals to hungry and homeless people in Victoria using food donated by businesses. FareShare ‘rescues’ food that would otherwise have ended up as waste in landfill. Not only is this business’s work helping those in need, it is also helping the environment.

**FIGURE 8.58** The FAIRTRADE Label guarantees that disadvantaged producers in the developing world receive a fair price for their commodities.
Ethical business behaviour

Ethics are standards that define what is acceptable and unacceptable behaviour. Ethics involves the study of moral issues and choices. It is concerned not with legal obligations but with what is morally right or wrong — and all the shades of grey in between. In many decisions involving ethical questions, it is sometimes difficult to give a definitive answer as to what is ‘right’ and what is ‘wrong’. It often depends upon the individual circumstances surrounding the situation. Business ethics is the application of moral standards to business behaviour.

Like individuals, businesses are frequently confronted with ethical dilemmas. What does a business do:

• with a loyal, long-serving employee who cannot adapt to new technology?
• with confidential information about a competitor’s pricing policy that a disgruntled employee leaked?
• when it is asked for a cash payment to help hasten a decision about a tender contract?
• when a competitor engages in unethical business tactics that allows it to offer a cheaper product?
• when it outlines a promotion plan for an employee but later is unable to follow through with the plan?

These are just a few of the ethical challenges that confront business owners and managers. How they respond to these situations will have long-lasting consequences for the image and reputation of the business, as well as the behaviour of employees. It is important for business owners and their managers to have high personal and ethical standards so employees perceive the importance of ethical considerations. Much of the evidence that ‘good ethics is good business’ is anecdotal. However, when James Burke, the former head of US company Johnson & Johnson, looked at the performance of a select group of companies committed to best ethical practice, he found that their stock value had increased by 11.3 per cent over a 40-year period. Over the same period, all other stocks increased in value by only 6.2 per cent on average.

Socially responsible management — everyone wins

Late one evening in 2008, Harriet Michaels, owner of OzInteriors, a furniture store in a large regional town, was showing some overseas guests around her neighbourhood. As Harriet and her friends drove past the central park, they were stunned to see some homeless young people sleeping at the back of the maintenance block.

Harriet was puzzled by what she had seen: why didn’t the young people want to go to the local welfare shelter? Over the next few days she went to investigate. Nothing she had seen or read prepared her for what she discovered. The welfare officer at the local hostel described how difficult it was to accommodate all those who needed shelter. The rooms were overcrowded, the bathroom facilities needed repairing and the dining room was basic. The hostel was severely underfunded. Harriet soon realised that living conditions in the hostel were draining the hope the young people may have once had.

SNAPSHOT

• Harriet wanted to give something back to the community.
OzInteriors was one small business that decided to practise socially responsible management and consider the welfare of the community, not just the objective of making a profit. Socially responsible management is sometimes referred to as ‘corporate social responsibility’, but you don’t have to be a large corporation in order to be socially responsible — many small businesses make a worthwhile contribution to their communities. As a successful businessperson, Harriet wanted to give something back to the community and so began the Welcome Home program. Harriet contributed both time and money (a portion of her business’s profits) to help with the refurbishment of the hostel. She also organised and funded a program that gave the hostel residents vital living skills.

Harriet is motivated by a desire to use her business to bring about a positive change within her community. To date, the Welcome Home program has assisted 58 homeless young people to complete their secondary education and move into employment.

Apart from the personal feeling of satisfaction from contributing part of the business’s profits to the community, there is overwhelming evidence that being a good corporate citizen can actually be good for business. For example, Ira Jackson and Jane Nelson propose in their book *Profits with principle: seven strategies for delivering value with values* that businesses combining a desire to maximise profit with a concern for the welfare of the broader community perform better than those that focus only on profit-making.

**Snapshot questions**

1. Identify the factors that motivated Harriet Michaels to establish the Welcome Home program.
2. Predict the ways that OzInteriors might benefit from funding the Welcome Home program.

**Ethical issues**

Within the business world, the following ethical issues regularly occur.

**Fairness and honesty**

Businesses must obviously obey all laws and regulations. As well, society expects businesspeople to tell the truth and avoid using misleading or deceptive information. Employees expect to be dealt with honestly and fairly. If, for example, a business promises a promotion to an employee, then the business should honour this commitment to the employee (except in exceptional circumstances). Customers and suppliers also expect to be treated honestly and fairly in all their business dealings. If, for example, a business arranges for a delivery of certain items and promises to pay within a set time, then the business should honour this commitment to the supplier.

**Respect for people**

If business owners treat their staff with respect, then you would also expect employees to act ethically.

Occasionally, a business may become aware of an unethical practice of an employee. This can place the business in a difficult position, especially if the employee is important to the successful operation of the business. At other times, an employee may be placed in a difficult ethical position by other employees — for example, when older employees decide to play a practical joke on a young apprentice. Sometimes, these practical jokes get out of hand and may develop into a serious harassment or negligence case. Other serious workplace ethical issues may...
involve a situation where confidential information is not kept secret, obligations are not fulfilled or subtle forms of discrimination occur.

**Conflict of interest**

Conflict of interest occurs when a person takes advantage of a situation or piece of information for his or her own gain rather than for the employer's interest. Such conflicts can often occur when gifts or payments are offered. There is a fine line between what is regarded as a gift and what may become a bribe. Corruption undermines the integrity of the business and, if unchecked, infiltrates the workplace culture.

Once a pattern of corruption takes hold and is seen to be acceptable behaviour, it quickly becomes entrenched within the business. Changing the attitudes and practices of individuals within such a business is extremely difficult. What start off as small incidents to which most people turn a blind eye may soon develop into corruption on a grand scale. When such corrupt practices are eventually exposed, the business's image will be severely damaged.

**Financial management**

Businesses have ethical and legal responsibilities in relation to financial management. In recent years, unethical practices have been highlighted and increasingly questioned. There are growing calls for codes of behaviour to regulate the activities of businesses in relation to financial management.

It is generally accepted that financial management decisions must reflect the objectives of a business and the interests of shareholders. An area in which ethical considerations are important is the valuing of assets.

In preparing budgets, a business estimates its expenditures and revenues. The common practice of overestimating expenditures and understating revenue to allow for unexpected and uncertain events is an ethical issue for an organisation.

All financial records should be regularly audited. Internal and external audits assist in guarding against unnecessary waste, inefficient use of resources, misuse of funds, fraud and theft.
Truthful communication

Advertising can represent real ethical dilemmas. False or misleading advertising is not only unethical, it is also illegal. Terms such as ‘special’, ‘sale’, ‘low fat’ or ‘light’ can be misleading. For example, what precisely does the word ‘special’ mean when it is displayed above a product for sale? Most consumers would take this to mean the item is for sale at a cheaper than normal price; however, this may not necessarily be the case. The business owner may interpret the word ‘special’ to mean that the product has a distinct or particular character, that it can perform a particular function or it is different from what is ordinary or usual. The two interpretations can easily be confused. If the businessperson uses this word attempting to knowingly mislead customers, it would be classified as unethical behaviour. If the businessperson wants to advertise the fact that the product is available at a bargain price, then the words ‘on special’ would have a clearer meaning.

![FIGURE 8.61](image)

FIGURE 8.61 When a store advertises a closing down sale, you expect that the store will close shortly afterwards. This is not always the case.

Encouraging ethical business behaviour

It is not always easy to maintain a consistently high degree of ethical behaviour in the real world. Employees who want to act ethically sometimes find it difficult to do so, especially if unethical practices are ingrained into the workplace culture.

One strategy that can be implemented to encourage ethical behaviour is to devise a **Corporate Code of Conduct**. This is a set of ethical standards for managers and employees to abide by.

Many businesses now document and distribute their codes of conduct or core values in order to provide internal stakeholders with ethical guidelines for workplace behaviour and practices.

Training may be given to employees to ensure they understand the values of the business. Most businesses also establish formal proceedings for reporting unethical behaviour in the workplace.
Summary

- The majority of businesses want to be seen as responsible corporate citizens.
- The triple bottom line refers to the economic, environmental and social performance of a business.
- Ethics are standards that define what is acceptable and unacceptable behaviour.
- Business ethics is the application of moral standards to business behaviour such as:
  - fair and honest business practices
  - decent workplace relations
  - conflict of interest situations
  - accurate financial management
  - truthful communication.
- A corporate code of conduct encourages ethical business behaviour.

Revision

1. State the benefits of managing a business in an ethical and socially responsible manner.
2. Explain whether it is ethical for your school authorities to monitor student email usage on the school’s computer resources.
3. ‘Everyone cuts corners in business. It is the only way to survive.’ Discuss this statement.
4. Identify the three components that make up the triple bottom line.
5. Outline what Etiko does that makes it ethically and socially responsible.
6. Use the Etiko weblink in your eBookPLUS to examine Etiko’s business practices in detail.
7. Distinguish between ethical and unethical behaviour.
8. Recall what James Burke’s research revealed.
9. Construct a concept map outlining the five main ethical issues constantly faced by business.
10. Discuss what you believe to be the most ethical way to behave in the following situations and then compare your answers with other class members. Discuss any similarities or differences.
   (a) A customer is unaware that you have accidentally overcharged her. Do you inform the customer and give back the money or keep it yourself?
   (b) Your boss has told you not to record all the cash payments so as to reduce his taxation payments. Do you comply with these instructions? As an employee, what difficult position have you been placed in? How could you justify your decision?
   (c) A disgruntled employee from your main competitor offers to provide you with confidential information from that business’s marketing strategy. Would you accept such information? Give reasons for your answer.
   (d) An employee is suspected of misusing the business’s internet facilities. However, the employee is the best salesperson in the business, generating thousands of dollars worth of sales each year. How should the employee be dealt with?
11. (a) Define the term ‘conflict of interest’.
    (b) In small groups, propose some possible strategies a business could use to minimise conflict of interest situations arising.
12. Explain how a code of conduct could help encourage ethical business behaviour.
13. Identify what is required for a code of conduct to work successfully.
14. Use the St James Ethics Centre weblink in your eBookPLUS. Select the option ‘Get involved’ and then click on ‘Dilemma’. In small groups, answer the ethical questions raised with the dilemma. Discuss your answers with other groups.
Extension

1 Extrapolate how socially responsible and ethical business practices might increase a business’s sales and profit.

2 Create a list of five principles that could be included as part of the code of conduct for your school.

3 You have been contacted by Spencer Manufacturing Limited to assist in the development of a Corporate Code of Conduct. Create a series of guidelines that can be incorporated into a code of ethics for the business. Share your guidelines with other class members.

4 ‘Improving a business’s ethical performance depends on the values of its managers and employees, and the business’s culture.’ Analyse this statement.

5 ‘Ethical business practices do not just happen: they are carefully planned and implemented. Such practices filter through the business. In return, employees are more loyal, committed and proud to work at such a business.’ Assess the importance of business owners adopting ethical business practices.

6 Use the Fair Trade weblink in your eBookPLUS to examine the ways the movement is committed to ethical trade and production practices.