Business Administration Standards

Principles of Business

Introduction

There are a few basic principles that are essential to the success of any business, whether it's a multinational or run by one person.

These are:

- Get organised – you will spend less time looking for things.
- Control stress – remain calm and you'll be more effective.
- Research – there are a whole range of books available on how to be successful.
- Be passionate – if you're not, then work will become hard.
- Budget – when you are in control of your finances, you can stop stressing about money and focus on what makes you successful.
- Value your health – you will become more successful if you take care of yourself and look more presentable.
- Embrace selling – even if you have nothing to do with sales, you are still selling yourself.
- Satisfy customers – go over and above what you say you will do, and customers will remember you for it.
- Network – collect people's contact information and store it in a database.
- Maintain cash flow – this principle is more for business owners and managers than for employees, but it is crucial to keep money coming in.
- Achieve a work/life balance – remember what is important and do things that you enjoy outside of work.

In this development area you will cover the following elements:

1. understand business markets
2. understand business innovation and growth
3. understand financial management
4. understand business budgeting
5. understand sales and marketing.

Explanation of words used in this booklet:

Communist:	A political theory or system in which all property and wealth is owned in a classless society by all the members of that society
Stagnation:	Failure to develop, progress or make necessary changes
Transact:	To conduct or carry out something such as business
Niche:	A specialised part of a market
Demographics:	Groups of people characterised by age, income, sex, education, occupation, socio-economic group etc.
Bottom-line Effect:	The effect on the net profit or loss
Viability:	The long-term survival of an organisation and its ability to have sustainable profits over a period of time
Capitalised:	An asset that is regarded as a capital asset when determining Income Tax liability
Variance:	A difference between two or more things
Phasing:	Any distinct or characteristic period or stage within a sequence of events
Fluctuate:	To change often from high to low levels or from one thing to another

Business Markets

Different types of organisations will have different characteristics including:

- purpose
- finance
- ethos
- structure
- customers
- ownership.

These characteristics will be explored in this chapter. There are three basic types of market systems:

- free market
- command market
- mixed market.

Free Market

In a free market, resources and industries are owned completely by private individuals. In this system, two parties enter into an agreed exchange that is mutually beneficial. A free market system is driven by the goal of profit, which is determined mostly by consumer demand. The government plays only a remote role, ensuring only that the market remains stable.

Exchanges in a free market system can be as simple as buying and selling a cup of tea. The tea shop is owned completely by the merchant, but the customer has the power to shape the business through providing repeat business or by going to a competitor. The competition encourages all tea shops in the area to have competitive pricing or to offer a clearly superior product.

The market system has many benefits but also some drawbacks, including:

- possible shortages and surpluses due to market fluctuations
- income differences that can lead to a society of very rich and very poor people, with few in between
- public services such as defence, health care and education that are used by everyone but towards which not everyone pays an equal share of the costs.

Command Market

The command market is also known as the ‘planned economy’ or ‘planned market’. It works through central planning by a government that owns all the resources and controls all aspects of the economy, including:

- what and how much is produced
- financial compensation to workers
- prices of products and who can receive them.

This type of market usually operates in ***communist*** countries. The benefits of a true command market system include a similar standard of living for all citizens, with little homelessness and no inflation due to government price controls, but this common standard of living tends to be the lowest, not the highest, standard. The command system has a number of drawbacks, including:

- limited product selection
- needs determined by a central planning authority that aren’t truly compatible with what the society requires or wants
- restriction of personal freedom.

The command market system can end up damaging the economy through ***stagnation***. When workers don’t own the resources and receive the same amount of compensation regardless of what they do, there is no incentive to improve existing products or make innovations. This can lead to loss of technological and financial progress.

Mixed Market

The third type of market is the mixed market. Most countries operate an economy somewhere between a free market and a command market economy. In a mixed market there are various types of market operating alongside each other.

Competitive markets

Competitive markets have multiple buyers and sellers. In a perfectly competitive market:

- no individual supplier has a dominant market share
- standardised or similar products are supplied by each supplier
- customers have full information about prices and trends
- all sellers in the market, whether new or existing, have equal access to technology and other resources
- there are no barriers to entry into the market or exit
- the market is open to external competition.

A competitive market serves as a benchmark for other real-world markets.

Monopoly markets

A monopoly or monopolistic market is one that has only one seller that has the independence to raise and lower prices without affecting the demand for its services and products. Monopolies serve the needs of sellers but are harmful to customers. They are characterised by:

- an absence of economic competition
- technological superiority
- no substitutes for the goods sold (i.e. customers do not have an alternative)
- a seller having full control of market power, with the ability to lower and raise prices without losing clients or customers.

Monopolies can form for a variety of reasons, including:

- a firm having exclusive ownership of a scarce or essential resource, as with Microsoft's original dominance of the Windows operating system for PCs, it has monopoly power over this resource and is the only firm that can exploit it
- government granting a firm monopoly status, as with the Post Office which was given monopoly status by Oliver Cromwell in 1654
- producers having patents over designs or copyright over ideas, characters, images, sounds or names, giving them exclusive rights to sell a good or service, such as a songwriter having a monopoly over their own material
- following the merger of two or more firms – such mergers are subject to close regulation and may be prevented by the government if the two firms have a combined market share of 25% or more.

Monopsony markets

A monopsony is a type of market in which a single powerful buyer controls and affects market prices. Multiple sellers offer goods and services, but there is only a single buyer who has exclusive control of market power and can bring the prices of goods/services down. A pure monopsony is rare, and is most often found in the context of a large employer in a small town having a monopsony on the available work force. Examples of monopsony purchasers include:

- major employers in a small town, such as a car plant, a major supermarket or the head office of a bank
- nursing homes as employers of care assistants
- the government as the major purchaser in the teaching profession or in the NHS
- local authorities for example in refuse collection, street-cleaning and in running council nursing homes and local libraries

- agencies, which employ thousands of people in the hotel, catering and cleaning industries
- the farming sector, which employs huge numbers of people on temporary terms during the peak harvesting season.

Oligopoly markets

An oligopoly market is characterised by a limited number of competing sellers who sell similar or different products. Sellers compete with each other through aggressive advertising and improved service delivery. An oligopoly sets barriers to entry and makes it difficult for new sellers to enter the market. Barriers include:

- patent rights
- financial requirements
- legal barriers.

Tobacco companies and airlines are examples of oligopolies.

Oligopsony markets

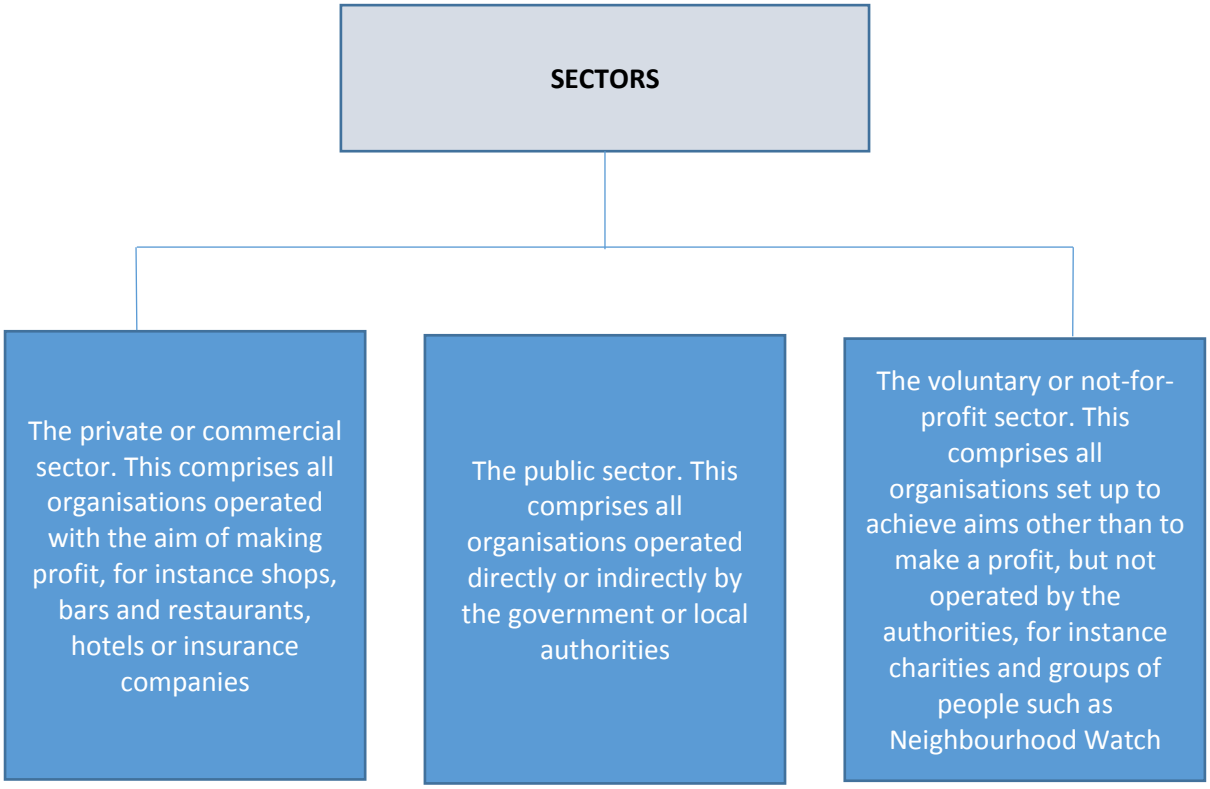
An oligopsony market has few buyers but multiple sellers.

A duopsony is a type of oligopsony that has two buyers. The buyers affect each other's buying action. An example of an oligopsony is the market for cocoa. There are three large firms that purchase the majority of cocoa bean production around the world. These three firms therefore control most of the world's cocoa supply.

The sellers of cocoa beans must compete to receive business from one or more of these three firms. The three firms therefore have an extraordinary amount of power over the sellers and can dictate where the cocoa beans are grown, how they are grown, how they are sent and how they are sold.

Types of Organisation

The economy of the UK can be divided into three main sectors:



The Private or Commercial Sector

Organisations that are set up to make a profit may be any of the following.

Sole traders

This means the business is owned by one person, who takes all the financial risk of operating the business in return for all the profits. Sole traders are personally responsible for any losses the business makes, bills for things they buy for the business (like stock or equipment) and keeping records of the business's sales and spending.
Sole traders must register with HM Revenue and Customs (HMRC) as soon as they can after starting the business. Sole traders must send a self-assessment tax return every year, pay Income Tax on their profits, pay National Insurance, and register for VAT if they expect the business's takings to be above a threshold that the government sets each year.

Partnerships

Two or more people own the business and share the risks and profits. The partners may own equal or unequal parts of the business, and the risk and profit is shared proportionately. Profits are shared between the partners and each partner pays tax on their share of the profits. Partners are personally responsible for their share of any losses the business suffers, and for bills for things bought for the business such as stock or equipment.

A partner doesn't have to be an actual person. For example, a limited company counts as a 'legal person' and can also be a partner in a partnership.

To set up as a business partnership, a ‘nominated partner’ must be chosen to be responsible for keeping business records and managing tax returns. The nominated partner must register the partnership with HMRC. When they do this, they will automatically register personally for self-assessment. The other partners must register individually.

The nominated partner must send a self-assessment tax return for the partnership every year, and all the partners must send a personal self-assessment tax return every year, pay Income Tax on their share of the partnership’s profits, and pay National Insurance. The partnership will also have to register for VAT if they expect its takings to be above the threshold.

Corporations

Corporations may be public limited companies or private limited companies. A limited company is an organisation that you can set up to run your business. It’s responsible in its own right for everything it does and its finances are separate to the owners’ personal finances. Any profit it makes is owned by the company, after it pays Corporation Tax. The company can then share its profits.

Every limited company has members or shareholders who own shares in the company and elect a board of directors. The company’s directors are responsible for running the company. The directors often own shares, too, but they don’t have to.

Because the shareholders of a company limited by shares are distinct ‘legal persons’ quite separate from the limited company itself, the direct liability of such shareholders to outsiders with whom the company has dealt is nil. However, such shareholders may indirectly be liable up to the limit of the amount which they have agreed to pay the limited company for their shares and which remains unpaid.

Shares in limited companies can be bought and sold. Public limited companies have ‘floated’ and have their value listed on a stock exchange, so the shareholders in these companies regularly change. In contrast, shares in private limited companies are traded privately, the shares aren’t listed and so they change hands less frequently. Some of the profits are distributed to the shareholders as dividends, based on the number of shares they hold.

Co-operatives

Co-operatives are owned by their members, who may be employees or customers. Profits are distributed to members based on their salary (if they are employees) or spend (if they are customers). In legal terms, co-operatives usually take on the form of one of the types of corporation described above.

Franchises

A franchise exists when firms that already have a successful product or service enter into a relationship with other businesses to operate under the franchiser’s trade name, and usually with the franchiser’s guidance, in exchange for a fee. Some of the most popular franchises include Subway and McDonalds. The legal form of a franchise can be any of those described above.

The Public Sector

The public sector consists of:

- government departments such as the Home Office, the Foreign and Commonwealth Office and the Treasury
- non-ministerial government departments such as the Office for Standards in Education (Ofsted), Her Majesty's Revenue and Customs (HMRC) and the Charity Commission
- executive agencies such as the Food and Environment Research Agency, the Rural
- Payments Agency and the Maritime and Coastguard Agency
- non-departmental public bodies (NDPBs) such as the Environment Agency, Sport England and the Royal Commission on Environmental Pollution
- local authorities such as county councils, district councils and unitary authorities
- public corporations such as the Audit Commission, the BBC and the Civil Aviation Authority
- trusts such as the BMA Medical Educational Trust and the many NHS Trusts.

Public sector organisations differ in terms of purpose, size, budget, service provided, customers, governance, values and ethics. For instance:

- the stated purpose of the Home Office is control of immigration and passports, drugs policy, counter-terrorism and the police
- the Charity Commission regulates registered charities in England and Wales and is responsible for maintaining the register of charities and making charities accountable
- the Rural Payments Agency provides rural payments, rural inspections and livestock tracing, and enforcing the size and shape of vegetables and fruit sold in shops by warning and advising businesses
- the Royal Commission on Environmental Pollution advises the government on environmental pollution
- local authorities provide public services such as schools, social services, public transport, council housing, leisure facilities, planning, recycling and refuse collection.

The Voluntary or Not-For-Profit Sector

Organisations that are run for purposes other than to make a profit are often run in much the same way as profit-making organisations. The difference is that their purpose is to raise money to promote a cause.

Often they are run by volunteers, although paid staff may be employed for their expertise in fundraising or carrying on the business operations of the organisation. Among the not-for-profit organisations are:

Charities – these are often registered with the Charity Commission, or in Scotland with the Office of the Scottish Charity Regulator, and must conform with strict criteria in order to operate as registered charities.

Community interest companies (CICs) – these are social enterprises set up to tackle a wide range of social and environmental issues. Their surpluses are re-invested for the benefit of the community.

Trade unions – these are organisations of workers that negotiate wages, working conditions and health and safety rules for their members. Their income is derived from members' subscriptions and used for the benefit of members.

Industries

Organisations can also be characterised by their position in the supply chain. Different types of organisations include:

- Extractive industries – these produce raw materials through mining, quarrying, dredging, and oil and gas extraction. Mining is the extraction of metals and solid fossil fuel in either an underground mine or in an above ground mine, known as a surface mine, 'open-cast mine', 'open-pit' or just 'pit'. Quarrying is the extraction of aggregates and industrial minerals above ground. Dredging is the extraction of marine aggregate underwater. Oil extraction is the extraction of liquid fossil fuel and gas extraction is the extraction of gaseous fossil fuel.

- Manufacturers – these produce merchandise for use or sale using labour and machines, tools, chemical and biological processing, or formulation. Raw materials are transformed into finished goods on a large scale. These goods may be used for manufacturing other more complex products or sold to wholesalers.

- Wholesalers – these sell goods or merchandise to retailers, industrial, commercial, institutional, or other professional business users or to other wholesalers.

- Retailers – these sell goods and services to an end-user. Retailing can be done in either fixed locations such as stores or markets, door-to-door or by delivery. An increasing amount of retailing is done using online websites via electronic payment.

- Service providers – these provide consulting, legal, real estate, education, communications, storage, processing and other services.

Types of Market

A market is anywhere where buyers and sellers come together to ***transact*** with each other. The traditional image of a market is a place where buyers and sellers come together in one place. This still happens: the UK has many towns that are referred to as 'market towns', so called because they host a town-centre market on regular dates throughout the year. Car boot sales are another classic example of a physical market in action.
There are two main categories of physical market:

- Local markets where customers are a short distance from suppliers. These are often used for the sale of fresh and locally sourced products and the delivery of locally supplied services. The car boot sale is a great example of a local product market. The use of local services such as the local high street or retail park is another example, where consumer goods are sold to people who tend to live nearby. Businesses operating in local markets enjoy several advantages. They are physically closer to their customers so are better placed to understand local cultural issues and traditions. It is also easier to develop relationships with local customers, to engage in market research and to respond quickly to changes in the market. The main disadvantage to operating in local markets is that the market size may be relatively small.

- National markets, where customers are spread throughout the country or over a large area. The same product or service is offered to customers through many locations in the country. For example, there are branches of Sainsbury's, McDonald's and Greggs in almost every town and city.

However, the buyer and seller don't have to be in the same physical place in order to conduct transactions with each other. A much larger number of markets are now electronic. Businesses find their customers using electronic media, including the internet, mobile telephones, television and email. Transactions are completed electronically with the delivery method depending on the nature of the product sold. For example, items bought and sold on eBay, Amazon or iTunes, or bought from a catalogue by making a phone call, are all examples of transactions in a market, although the buyers were not physically in contact with the sellers.

The key points about electronic markets include:

- They provide an easier way for start-ups to enter a national market, particularly if the business has identified a small ***niche*** segment of that market.

- They tend to be highly competitive on price since it is quite easy for customers to search for products from a variety of suppliers and to compare the best prices available.

- Start-up costs tend to be lower compared with entering a physical market.

Markets can also be sub-divided into 'consumer' and 'industrial' markets.

Consumer markets are markets for products and services that are bought by individuals for their own or family use. Goods bought in consumer markets include:

- Fast-moving consumer goods (FMCGs) – these are high-volume, low unit-value, fast-repurchase products. Examples include ready meals, baked beans and newspapers.

- Consumer durables – these have low volume but high unit-value. Consumer durables include ‘white goods’ such as fridge-freezers, cookers, dishwashers and microwaves, and ‘brown goods’ such as DVD players, games consoles and personal computers.

- Soft goods – these are similar to consumer durables except that they wear out more quickly and therefore have a shorter replacement cycle. Examples include clothes and shoes.

- Services – such as hairdressing, dentistry and childcare.

Industrial markets involve the sale of goods between businesses and are not aimed directly at consumers. Industrial markets include those:

- selling finished goods such as office furniture and computer systems

- selling raw materials or components such as steel, coal, gas and timber

- selling services to businesses such as waste disposal, security, accounting and legal services.

Interactions

Businesses interact with each other in a variety of ways. These include:

- Supply chain transactions – The Council of Supply Chain Management Professionals (csmp.org) defines supply chain management as follows:

  Supply chain management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and all logistics management activities. Importantly, it also includes co-ordination and collaboration with channel partners, which can be suppliers, intermediaries, third-party service providers, and customers. In essence, supply chain management integrates supply and demand management within and across companies. Supply chain management is an integrating function with primary responsibility for linking major business functions and business processes within and across companies into a cohesive and high-performing business model. It includes all of the logistics management activities noted above, as well as manufacturing operations, and it drives co-ordination of processes and activities with and across marketing, sales, product design, finance and information technology.

- A typical supply chain begins with the ecological, biological, and political regulation of natural resources, followed by the human extraction of raw material, and includes several production links (e.g. component construction, assembly, and merging) before moving on to several layers of storage facilities of ever-decreasing size and increasingly remote geographical locations, and finally reaching the consumer.

- Logistics – this is the management of the flow of goods between the point of origin and the point of consumption, and usually involves the integration of information flow, material handling, production, packaging, inventory, transportation and warehousing.

- Advertising – this involves making the public aware of products and services through paid announcements in newspapers and magazines, via radio or television, on billboards, etc.

- Collaboration on loyalty rewards, discounts and joint promotions to share the cost and rewards of sales promotions.

Competition

Competition prompts invention as companies try to beat each other by creating new products and services to attract customers and increase sales. In turn, innovation benefits customers as companies produce better products and services. Innovation may cause changes in society and raise standards of living. Technological breakthroughs such as the airplane, car, phone and personal computer are inventions that resulted from competition and raised living standards.

Competition also causes companies to look for ways to reduce manufacturing costs to increase their profits. The savings benefit customers who eventually pay lower prices as manufacturing costs drop.
Businesses also conduct market research to identify consumer needs that their competitors may not be fulfilling and to develop products and services that meet these customer needs.

Competition among businesses also drives economic growth. New consumer electronic devices and advances in communications cause economies to grow worldwide. For example, changes in the technology industry encourage innovation and quickly expand consumers' product choices. Companies lower product prices to stay competitive as consumer demand grows for the newest electronic devices.

An organisation's goals may be shaped by the market in which it operates. A business is bound to fail unless it has a reasonable understanding of its target market. The business needs to understand:

- the needs and wants of its customers, and how these differ
- the buying behaviour of customers – why, what and how they buy
- the ways in which a market is split up into market segments to serve different customer needs
- the nature of demand in the market, how prices are set and the factors that influence demand
- the size and growth rate of the overall market and its segments ●● the proportion of market demand that is taken by competitors, known as market share.

Organisations' goals can also be shaped by:

- Climate change – if this proves to be a genuine phenomenon, it will affect the goals of many organisations. It is predicted that the earth's climate will rise by 3°C over the next 100 years which could result in:

- sea levels rising
- global food supplies reducing
- 3 billion people suffering increased water stress
- 290 million people being exposed to the risk of malaria
- tropical rain forests disappearing due to water shortages.

Legal Obligations of a Business

It is impossible to cover in detail all the legal obligations of a business in a book such as this. Small businesses need access to a reliable source of information such as the Citizens Advice Bureau, their local Chamber of Commerce or trade organisations, while larger businesses will employ experts to ensure they are complying with all the legislation and regulations that apply to their particular organisation.

The legal structure of the organisation can have significant long-term implications for the running of the business. As we have seen earlier in this chapter (see page 128), there are three main legal structures that organisations can operate as:

- sole trader
- limited company
- partnership.

A sole trader arrangement is the easiest to establish, although sole traders assume significant personal risk.
Industries whose actions could result in risk to members of the public, or who deal with hazardous materials, may need a licence. A catering or hospitality business, such as a pub or restaurant, will almost certainly require a licence. Businesses will need to be licensed if they serve alcohol, and may also need to register with their local authority for food standards and health and safety oversight. There are also various licence requirements for music and entertainment.

Business owners assume a range of important health and safety responsibilities. They have a duty of care for anyone who might be affected by the business. This might include members of the public (both inside and outside the premises), employees and visitors.
For businesses that take on staff, employers' liability insurance is a legal requirement. They run the risk of a significant fine for every day that they are uninsured, as well as being vulnerable to compensation claims from employees who suffer injury or illness as a result of their work.

Business owners also have a number of legal obligations to the taxman. These vary depending on the legal structure of the business but all have to file at least one annual return, and for businesses with staff the paperwork burden increases significantly. Companies must comply with the Companies Act 2006 and if your annual turnover exceeds the registration threshold you are legally obliged to become VAT registered. There are significant penalties for those that fail to register in time.

Organisations are bound by the Data Protection Act, which is covered in more detail in Chapter 2 and also have legal obligations in respect of their relationships with their employees.

Health and Safety Legislation

There is a wide range of legislation and regulation that affects health and safety in a business environment. The major piece of legislation is the Health and Safety at Work Act (HASAWA), which imposes duties on both employees and employers.

Employees must:

- work in a safe and sensible way
- use equipment safely and correctly
- report potential risks
- help identify training needs.

Employers must:

- provide a safe work area
- provide clearly defined procedures
- ensure safe handling, storage and transport of stock
- train and supervise staff in health and safety matters
- maintain safe entries and exits
- provide adequate temperature, lighting, seating etc.
- ensure visitors are informed of any hazards.

Employee-Protection Legislation

There are regulations to protect employees from being unfairly treated. These include:

- The Employment Relations Act – which covers among other things:

  - the recognition of trade unions
  - maternity/paternity leave and time off for dependants
  - the right to be accompanied at disciplinary and grievance hearings.

- The Employment Equality (Age) Regulations – which make it illegal to treat an employee less favourably because of their age in:

  - recruitment
  - promotion
  - terms and conditions
  - redundancy and dismissal.

- The Employment Rights Act – which includes sections on:

  - fair dismissal
  - complaints to a tribunal
  - reasonable notice
  - written contracts
  - rights to time off 2
  - flexible working
  - redundancy payments
  - compensation for lost earnings
  - time off for public duties, ante-natal care and training
  - dismissals related to health and safety
  - 'whistleblower' protection.

- Working Time Regulations – which impose an obligation on employers to ensure that employees:

  - work an average of no more than 48 hours per week calculated over a 17-week period including working lunches, job-related travel and time spent on business abroad
  - have an 11-hour continuous rest period between working days
  - have a continuous 24-hour period off work each week
  - have a break of 20 minutes if the day is more than six hours long.

- The Employment Act – which includes sections on:

  - paternity leave and pay
  - maternity leave and pay
  - adoption leave and pay
  - dispute resolution.

- The National Minimum Wage Act – which applies to anyone who has a contract to do work personally, other than for a customer or a client. Those working through agencies and home workers are also included. The Secretary of State can make exclusions, as has been done for au pairs and family members in a family business, among others. The hours that are used in a national minimum wage calculation do not include time when the worker is on industrial action, travelling to and from work, or absent, but a worker who is required to be awake and available for work must receive the minimum rate. This does not prevent use of 'zero hour contracts', where the worker is guaranteed no hours and is under no obligation to work.

- The Human Rights Act – adapted parts of the European Convention on Human Rights and allows workers to sue their employers for breaches of their rights, but only if that employer is a public authority. Employees are entitled to their privacy and cannot be discriminated against for any aspect of it. Employers have the right to monitor employees for health and safety or security issues but cannot do this at all times, and staff are entitled to see what is filed away about them. All public authorities have a drug misuse policy in place, but employers cannot test for drugs or alcohol without express consent, which may be given when employees signed their contract of employment. Any random testing must be genuinely random, although employers can test certain employees by virtue of their particular job, for instance if they are a driver or a heavy- machinery operator.

In addition, the Equality Act gives protection from unlawful discrimination in relation to the following protected characteristics:

- age
- disability
- gender re-assignment
- marriage and civil partnership
- pregnancy and maternity
- race
- religion and belief
- sex
- sexual orientation.

The following pieces of legislation are absorbed into the Equality Act:

- The Equal Pay Act – made it illegal to offer different pay and conditions to men and women who perform the 'same type of work', which was defined as work of equal value in terms of effort and skill.

- The Race Relations Act – made it illegal to treat employees differently because of their race, colour, nationality or ethnic origins.

- The Sex Discrimination Act – made it illegal to treat employees differently because of their gender.

- The Disability Discrimination Act – made it illegal to discriminate against disabled people in the areas of employment, access to goods, facilities and services, and management, buying or renting land or property.

Business Innovation and Growth

Organisations change in order to grow, improve performance and, in the private sector, remain competitive. Change may be initiated by external forces beyond the control of the organisation. For example, alterations in the ***demographics*** of the customer base, levels of unemployment, inflation and technology can all affect the way organisations carry out their work. Failure to react to these changes will leave the organisation struggling to keep up.

Organisations themselves have a lifecycle of creation, expansion, contraction and decline. Successful organisations look for ways to extend the expansion phase and delay the contraction phase of this cycle. Extending the expansion phase may be accomplished through:

- mergers – where the organisation joins with another to create a new entity

- acquiring new companies – where the organisation absorbs another

- new ownership – where the organisation itself is taken over

- relocation of the organisation to a new site – which may be closer to customers, more efficient to operate or help create an improved image.

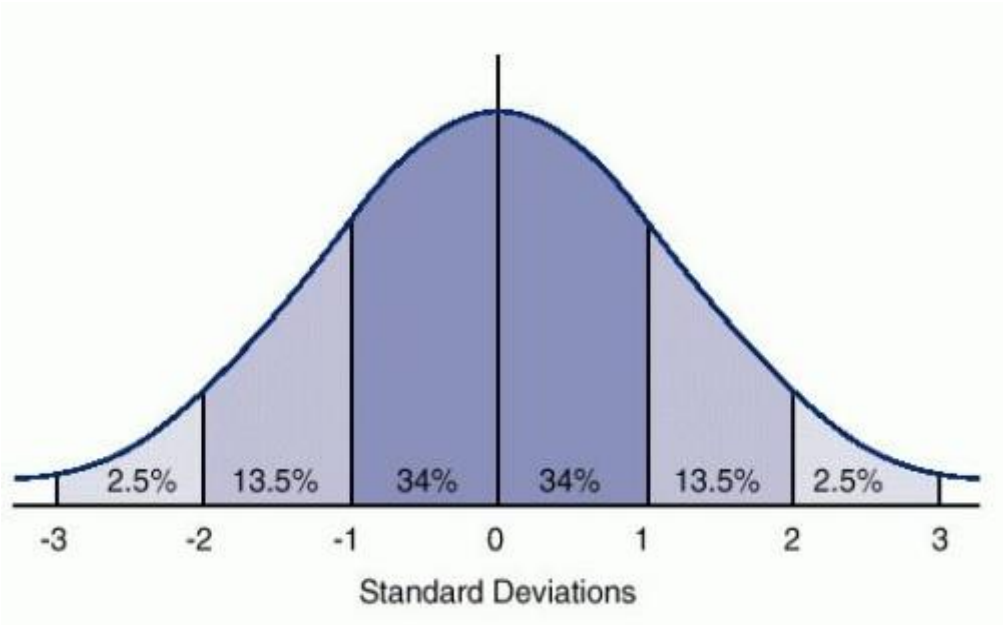
Changes that may initiate the contraction phase include:

- loss of revenue and rising costs
- legislative changes that affect the operation of the organisation
- economic changes that affect the purchasing power of the customers
- political changes, which particularly affect public- and voluntary sector organisations.

What is an innovation?

An innovation is a product, service or idea that is perceived by customers as new. There are different levels of innovation. Reducing the level of salt or sugar in an existing breakfast cereal is a continuous innovation in that it creates a small change to an existing product with little market impact, while an innovation like the personal computer, which caused great social impact, is a discontinuous innovation.

A business with an innovative strategy uses both continuous and discontinuous innovation to stay one step ahead of the competition.
The adoption process of a new product or service begins with customer awareness, leading to trial usage and ending in regular use. Over time the adoption process resembles a bell curve, as shown in the diagram.



The bell curve is formed by:

- Innovators – a customer who is among the first within a market to adopt an innovation. According to the bell curve model of diffusion, innovators are the first 2.5% of the consumers in a market to adopt an innovation.
- Early adopters – customers who are among the earliest to adopt an innovation, after the innovators, and represent 13.5% of the market.

- The majority of consumers – the first part of the mass market to purchase is the 'early majority'. Although rarely leaders, these consumers usually adopt new ideas before the average person and they represent 34% of the market.

- Late adopters – the 'late majority' also represents 34% of the target market. This group of people is usually sceptical of change and will adopt an innovation only after a majority has tried it.

- Laggards – the laggards represent 16% of the target market and are the last to purchase. They are usually price conscious, suspicious of change, tradition bound and conservative by nature.

- Diffusion is the process by which a new product or idea attracts the attention and interest of a market and is gradually adopted by the many individuals making up that market. Unlike individual adoption decisions, diffusion is influenced by communication about a product between an ever-widening group of customers and is affected by the social dynamics of the group.

Models of Business Innovation

There are a number of different innovation models that provide a framework for identifying the ideas most likely to create sustained growth. Characteristics to look for when deciding on an innovation model include:

- simplicity – the model should be easy to understand and use ●● descriptive – there should be sufficient detail to enable
- explanation, comparison and/or imitation

- assessable – the model should enable measurement and the evaluation of alternatives

- predictive – when model assumptions are true, the model should provide probabilities for described outcomes

- timely – the model should provide assessments, measurements and insights that enable innovation opportunities in a timeframe that will lead to success.

Timeliness can be particularly challenging. Innovation requires decisions for change which are often resisted, so a good model should provide the information, insight and needed motivation for internal change before external changes can disrupt the company. Premature change can also be ineffective if environmental conditions are not ready to support the change being promoted.

An effective model will detect environmental readiness for change adoption, enabling acceptable returns for innovation investments.

The linear innovation model can be summarised as:

The adoption of a new product or service begins with customer awareness

Basic research ➔ Applied research ➔ Development ➔ Production and diffusion

The continuing use of this model is attributed to its simplicity. Innovation research has generated additional models that attempt to address the deficiencies seen in the linear model. Attempts have been made to acknowledge sources of ideas that can help generate value, recognising that some highly successful innovations have not been the direct result of application of scientific or technology advances.

Variations of the linear model have been developed that include:

- Technology push – this has a small change from the linear model where 'marketing and sales' is added after 'production'.

- Market pull – this variant suggests that research and development is responding to a market need, resulting in this modification to the earlier model:

  Market Need ➔ Development ➔ Production ➔ Sales

- The phase gate model – this modifies the linear model by recognising that there are feedback loops and time variations between steps, and establishes readiness criteria for moving between major phases of innovation development. Phase gate approaches are often represented by a funnel approach.

- The connect and develop model – developed by Procter and Gamble in the 1980s, this model addresses the increasing cost of keeping all research and development within the company, representing an example of open innovation. In this model, parts of research and development come from outside the company as a result of networking and partnerships.

Detecting the need for change, or finding new places to generate growth, can present significant challenges for any organisation. Having an innovation model that facilitates and promotes understanding of how things change could make the difference to the long-term survival of the business. An effective model:

- provides a conceptual framework and promotes innovation thought

- aids faster identification of new sources of innovation

- facilitates better timing for market introduction

- helps find innovation opportunities aligned with timeframes needed for the business

- reduces the likelihood of competitive disruption

- increases return on innovation investment

- improves ability to anticipate needed innovation

- sustains competitive advantage and enables long-term growth.

An innovation model is a key element in creating competitive advantage and is critical for sustained growth in the business environment.

Models of business innovation include:

- Reviewing systems – there are four steps in developing an innovation system:

  - review formal and informal systems and processes
  - interview key stakeholders and staff members
  - understand the requirements and resources required
  - identify the key outputs required.

- Customer value propositions – which include the benefits that a customer receives from doing business with a particular seller. This addresses not only basics such as price but also related issues such as quality of service and support, prompt delivery and the relationship that is established between the customer and the supplier.

- Innovation ecosystems – there are three main components of an organisation's innovation ecosystem; mix of innovation types, structure (process, capabilities, culture, funding), and metrics and tracking. The right mix depends on the business and their innovation needs. There are three hierarchical levels of innovation within the business innovation ecosystem:

  - Core innovation – in most businesses the largest amount of effort in terms of time and resource will be given over to ideas and innovation within this category. These are typically more incremental improvements to existing products or services to optimise the delivery, return and experience for the existing customers.

  - Adjacent innovation – innovation involves an increasing level of risk as the business moves away from the core. This type of innovation can be very complex and result in high failure rates. It can involve taking existing products to new markets or, more commonly, developing value-added products or services to existing core propositions.

  - Transformational innovation is the highest risk of all the innovation categories. It can take up a huge amount of time, even be a distraction, and often be costly. Organisations will be looking for new products and services or new markets. This type of innovation is more popular with early stage and highly innovative businesses.

- Social innovations – social innovations are new products, services and models that simultaneously meet social needs more effectively than alternatives and create new social relationships or collaborations. Social innovations meet social needs of all kinds, from working conditions and education to community development and health, to extend and strengthen civil society

- Unique selling points (USPs) – in creating a USP look at what your competitors are doing and decide how you can differentiate yourselves from them. Ask 'What do you want to be known for?

  - quality
  - value
  - service
  - selection
  - no-risk purchase
  - lifetime guarantee.

You might want to be known for all of these things yet it's important you pick one out which makes the biggest statement about your company or product and which your competitors cannot rival.

THE BENEFITS, RISKS AND IMPLICATIONS OF INNOVATION

For a change that has financial implications for the organisation, there has to be a compelling business case. A business case looks at the cost of the change and weighs that against the benefits that the organisation will gain. If the benefits outweigh the costs, the return on investment (ROI) is positive and the change will be approved.

The formula for calculating return on investment is:

$$\frac{\text{Net project benefits}}{\text{Project costs}} = \text{ROI}$$

$$\text{ROI} = \frac{\text{Benefits of project} - \text{Project costs}}{\text{Project costs}} \times 100$$

In this formula:

- 'Benefit of project' is based on the project's purpose – the purpose could range from increasing sales to reducing the cost of handling customers. Organisations usually estimate that making certain changes to the business, installing new software, making processes more efficient etc. will yield a particular project benefit that has a financial amount associated with it.

- 'Project costs' includes hard costs, such as hardware and software, as well as what are sometimes termed 'soft costs'. Soft costs, for example, can include items such as the salaries for the time period people are on the improvement project. Salaries are important to include because the time employees spend on the improvement project should be seen as a cost to the organisation. The longer the project takes, the longer employees will be away from their primary job, whether it is sales, marketing or manufacturing. If they are working on an improvement project, they cannot spend the same amount of time they normally would on their regular job. While the model for many accounting systems has not shifted, research shows that these so-called soft costs are actually as or more important to a project's success than the hard costs. The argument is that, as a result, these costs should no longer be termed soft costs because they have a defined, ***bottom-line effect.***

Financial Management

The financial viability of an organisation is important to its investors, staff and stakeholders because it demonstrates the organisation's ability to generate sufficient income to meet its operating expenses and financial obligations, as well as providing the potential for future growth. Reviewing the current performance level and financial position of the business and considering the future will determine its financial viability.

To assess the financial viability of a business, the following questions should be asked:

- Is the business currently performing better or worse than it has in the recent past?
- Is the business generating enough income to support its needs?
- Can the business pay its creditors (people and other organisations that it owes money to) on time?
- Does the business need to borrow money to keep going?
- Could the business survive if unexpected events occurred that negatively affected sales?
- If the business is not currently profitable, do you see it becoming profitable in the future?
- How long can the business continue operating while making a loss?
- Considering all of the money, resources and effort put into operating the business, is it worthwhile continuing into the future?

Business owners usually acquire a general level of knowledge about running a business by operating their own venture. However, their knowledge may be limited and may not be sufficient to meet the complex needs of operating a successful business. It can be helpful to seek advice and assistance from professional advisers.

Professional business advisers work with their clients' businesses to provide specialised skills and knowledge in specific aspects of business operation. They also help ensure that all the business's obligations, requirements and entitlements are being met, and can help them obtain and manage their financial resources.

Professional advisers include:

- Accountants – offer advice and services on business planning, record keeping, preparation of financial statements, taxation compliance, estimating financial projections and determining future funding requirements.
- Bankers – provide advice and assistance on loan facilities, loan products, loan applications, cash flow management, risk management, money management, investment options etc.
- Solicitors/lawyers – offer legal services relating to issues such as contracts, leases, taxation, disputes, litigation, intellectual property, debt recovery etc.
- Insurance brokers – give advice on risk identification, risk assessment, risk minimisation, cost-effective insurance options, lodging insurance claims etc.
- Financial planners – help with developing financial strategies, tax planning, retirement planning and investment advice.
- Management consultants – advise on areas including human resource management, training, marketing and operations.

In addition to these professional business advisers, advice can be obtained from government agencies and advisory services. Many provide free information and assistance covering a range of business issues including business planning, finance, marketing, employment, legal and regulatory compliance etc.

Growth can be funded in only two ways: with profits or by borrowing. If expansion exceeds the capital available to support higher levels of debtors, stock, fixed assets and operating expenses (see the next section on Financial terms for definitions), a business's development will be slowed or stopped entirely by its failure to meet debts as they become payable. This can lead to insolvency, which will result in the business's assets being liquidated (sold off) to meet the demands of the creditors. The only way to avoid this is by planning to control growth.

Business Budgeting

There are three types of budget produced in most organisations: master budgets, capital budgets and operational budgets.

Master Budgets

The master budget is a one-year budget planning document covering all other budgets. It coincides with the financial year of the firm and may be broken down into quarters and into months. If the master budget is to be an ongoing document, rolling from year to year, then normally a month is added to the end of the budget to facilitate planning. This is called continuous budgeting.

The master budget is a comprehensive budget planning document. It usually has two parts, the operating budget and the capital budget. The operating budget shows the income-generating activities of the firm, including revenues and expenses. The capital budget shows the inflows and outflows of cash and other elements of the firm's financial position.

Capital Budgets

Capital budgeting is used to decide whether or not an investment is worthwhile. Organisations may have several opportunities to use their available capital and must measure the potential of each opportunity before choosing between them. They might be trying to decide whether to buy new equipment to expand production on an existing product, or whether to invest in research and development for a new product.

The three main methods of taking this measurement are:

- Internal rate of return (IRR) – this is a percentage used to compare a capital investment against other kinds of investment. Dividing the expected profit by the expected expenditure will calculate a percentage of return. The organisation will look at their other projects and determine its own minimum acceptable percentage of return, or its 'hurdle rate'. If the IRR is higher than the hurdle rate, the project is worth pursuing.

- Net present value (NPV) – this method determines how much cash will flow in as a result of the investment and compares that against the cash that will flow out in order to make the investment. Using this method, organisations also take into account the present and future value of money. Because of inflation, money earned in the future is worth less than the same amount of money would be today. Therefore, NPV

calculates all of the inflows and outflows over time, takes inflation and foreign exchange rates into account, and calculates the final benefit to the organisation.

- Payback period – this method calculates how long it will take to recover the investment in a project. If it will take one year to make back the investment from revenues from a new product, the payback period is '1'. The payback period method is out-dated and falling into disuse because it has some significant drawbacks. It doesn't take into account the time value of money, and tends to favour products that make most of their money up front rather than those that build momentum and can produce cash inflows over a longer period.

In reality, most organisations use more than one technique to help them with capital budgeting decisions. There are a number of minor methods, such as profitability index and sensitivity analysis, that can also be employed when making decisions. Since each method looks at the investment from a different perspective, it is best to employ multiple analyses and take the opportunities that all the techniques show has the best return.

Operational Budgets

The operational budget gives a clear financial picture of where the business is currently and where it expects to be in twelve months' time, through financial forecasts and details of investment in the business. It translates aims and objectives into financial terms so that the business can manage its financial resources effectively and meet its legal requirements in terms of accounting and tax.

Operational budgets provide a framework for responsibility and control by considering growth areas, competitors, cash flow and profit. They are usually created annually and give organisations:

- sound financial information
- greater focus
- ability to anticipate problems
- confidence in decision making.

There are four key steps in developing an operational budget:

1. Use historical information – collect all the historical information that is available on income and expenditure as this is an indication of likely future income and expenditure. It is only a guide, however, as you will need to take into account known variables such as sales plans and changes in the competitive environment.

2. Create a realistic budget – work out the relationship between variable costs and income and use the organisation's income forecast to estimate variable costs. Estimation provides as accurate a forecast as possible. Estimating each item line-by-line encourages consideration of all costs, potential variables and past experience, and allows for inflation and contingencies. Look at essential and non-essential expenses and the sources of best value for money. Timescales, priorities and financial resources must be balanced against each other in order to create a realistic budget that contains enough information to monitor income, costs and working capital.

3. Agree the format – agree with users of the budget a format that meets their needs and allows clear communication. The budget categories should allow for responsibilities and authority to be understood and facilitate co-ordination of effort, monitoring, control and feedback.

4. Involve other people – ask people with financial responsibilities within the organisation for estimates of their income and expenditure. Balance their estimates with yours and create an overall budget. If their combined estimates allow you to create a satisfactory overall budget, the job is done. Almost inevitably, there will be either too little income or too much expenditure in their combined estimates. It will be necessary to identify the key or limiting factor, negotiating with the budget holders to identify their needs and most effectively meet organisational objectives. Agreement must include agreeing the responsibilities and accountabilities of all involved. This will encourage acceptance of the budget which will ensure smooth implementation.

Monitoring Budgets

Having agreed a budget, it is important to monitor actual results against that budget in order to identify variances and take any necessary action. There are two areas to monitor:

- Income – compare actual income with the budget. Analyse the reasons for any shortfall, for instance low sales volumes or underperforming products. Look at any over performance; were targets unduly pessimistic? Look at the phasing of the budget; were seasonal variations (e.g. peaks and troughs in sales throughout the year) accurately budgeted for?

- Expenditure – fixed costs should be in line with budget. Variable costs should fluctuate in line with income. Analyse any reasons for changes in the relationship between variable costs and income. Look at the phasing of the budget; were suppliers' payment terms accurately accounted for?

It is important to understand variance when looking at budgets. A variance arises when there is a difference between actual and budget figures. Variances can be:

- Positive/favourable (better than expected) – this might mean that costs were lower than expected in the budget or revenue/profits were higher than expected.

- Adverse/unfavourable (worse than expected) – this might arise because costs were higher than expected or revenue/profits were lower than expected.

Variances may be a matter of concern, even though a budget is just an estimate of what is going to happen.

Monitoring the budget allows budget holders to improve efficiency and develop an awareness of the impact of their decisions on other areas and associated activities.

Budgets may need to be revised as a result of internal and external factors, such as new product development, industrial relations, inflation, recession, growth and employment, legislative and political factors.

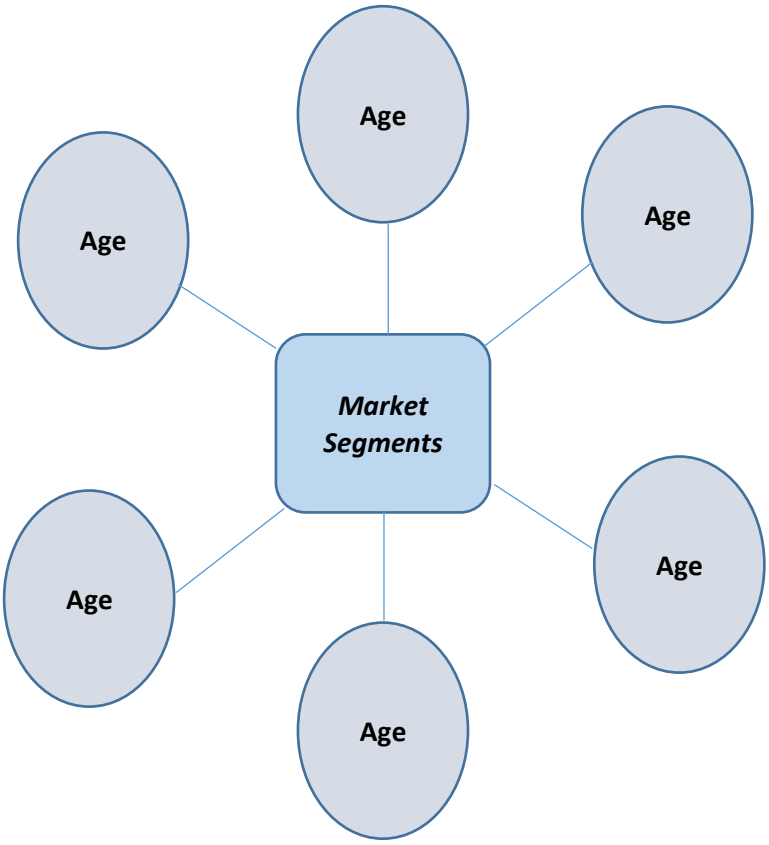
Budgets may also need to be revised as a result of errors in their preparation.

Sales and Marketing

The Principles of Marketing

Market segmentation is a central principle of marketing and an organisation's approach to segmentation will directly affect their success.

A market segment is an identifiable group of individuals, families, businesses or organisations that share one or more characteristic or need. Market segments generally respond in a predictable manner to a marketing or promotion offer. Common market segments include:



The market segmentation process involves six distinct steps:

1. Define the boundaries of the market. A formal business plan is used to develop a broad definition of the organisation's business, and the offerings of both direct and indirect competitors are used to gain information about the basic needs of consumers in the market.

2. Decide which variables to use in segmenting the market. Organisations use their knowledge of the market to select a few relevant variables in advance. This approach is generally less expensive and will likely provide more useful resources.

3. Collect and analyse data, which involves applying market research tools to identify market segments that are internally the same (i.e. similar customers), yet are distinctly different from other segments.

4. Develop a detailed profile of each market segment, which involves selecting those variables that are most closely related to consumers' actual buying behaviour.

5. Decide which segment or segments to target. Organisations look for customers with unsatisfied wants and needs that match the organisation and its resources. They consider the size and potential profitability of a market segment and whether the organisation can meet the needs of that segment better than its competitors.

6. Develop a product and marketing plan that will appeal to the selected market segment. This involves identifying the product features that are most important to consumers in the segment, and developing a marketing strategy that will attract their attention.

Customers are often prepared to pay more for a product that meets their needs better than a competing product. Small businesses in particular may find that market segmentation helps them compete with larger firms. Customers segment themselves when choosing between competing products and services by selecting the proposition that meets their needs better than any other. Therefore, organisations have to ensure that their offers meet the needs of customers better than any other and provide better value for money

The Marketing Mix

An important marketing principle, whether selling to consumers or businesses, is the marketing mix. Often known as **'the 7 Ps',** the marketing mix includes:

- People – it's important to find out if there are enough people demanding a product or service.

- Product – it's important to have the right products for the targeted market.

- Price – this is an area where organisations have to be careful and aware of what their target market might actually be willing to pay.

- Promotion – can include several components. How an organisation goes about promotion will depend on its budget, the message they want to communicate and the group of customers they are targeting.

- Place – approximately a fifth of the cost of a product goes on getting it to the customer. 'Place' is concerned with various methods of transporting and storing goods, and then making them available to the customer.

- Process – this refers to the process by which the organisation gets paid and delivers their products. For most digital products this is all done online, while physical products or services might require the use of a distribution company.

- Physical evidence – this relates to how the organisation and its products are presented in the market place. A strong brand image helps to increase sales and retain customers.

The Value of a Brand

A brand is a name, phrase, sign, symbol or design (or a combination of them) intended to identify the goods and services of the organisation and to differentiate them from those of other sellers. Branding is not about getting your target market to choose you over the competition, but it is about getting your prospective customers to see you as the only one that provides a solution to their problem. The organisation's brand lives in the hearts and minds of its customers, clients and prospects. It is the sum total of their experiences and perceptions, some of which can be influenced and some of which cannot.

A good brand will:

- deliver the message clearly
- confirm your credibility
- motivate the buyer
- concrete user loyalty.

To succeed in branding, an organisation must understand the needs and wants of its customers and prospects. They do this by integrating their brand strategies into every point of public contact.

A strong brand is invaluable as the battle for customers intensifies day by day. It's important to spend time investing in researching, defining and building the brand. The brand is the source of a promise to your consumer. It's a basic piece of the organisation's marketing communication and one they wouldn't want to be without. Coherent branding will involve the organisation's logo, the campaign name, the key message, a strong design and recognition.

The Relationship between Sales and Marketing

Larger organisations that rely heavily on sales and meeting important sales targets often make sales a separate department from marketing, with the result that sales people are managed by people who understand and support sales. The sales department will have a manager to liaise with other parts of the company to ensure smooth co-operation and support of sales. In this environment, companies often see stronger sales results.

However, instead of making sales a separate department, many other businesses attach a sales force to another department. For example, a department that is in charge of a particular line of products may include everyone from managers to designers to salespeople.

Making salespeople part of the unit ties them in to the information, the concepts and the team's success, which can drive them to hit targets and objectives. The downside can be that salespeople are then managed by departmental managers who aren't likely to have sales experience, and may or may not support salespeople in the ways that they need.

The role and responsibilities of marketing personnel also vary from organisation to organisation, but a typical job description would be:

- Contributes to and develops integrated marketing campaigns.
- Liaises and networks with a range of stakeholders, including customers, colleagues, suppliers and partner organisations.

- Communicates with target audiences and manages customer relationships.
- Sources advertising opportunities and places adverts in the press – local, regional, national and specialist publications – or on the radio, depending on the organisation and the campaign.
- Manages production of marketing materials, including leaflets, posters, flyers, newsletters, e-newsletters and DVDs.
- Writes and proofreads copy.
- Liaises with designers and printers.
- Organises photo shoots.
- Arranges for the effective distribution of marketing materials.
- Maintains and updates customer databases.
- Organises and attends events such as conferences, seminars, receptions and exhibitions.
- Sources and secures sponsorship.
- Conducts market research, such as customer questionnaires and focus groups
- Contributes to and develops marketing plans and strategies.
- Manages budgets.
- Evaluates marketing campaigns.
- Monitors competitor activity.
- Supports the marketing manager and other colleagues.

A marketing department can have difficulty understanding how successful a particular campaign has been. In an organisation where the sales and marketing departments are working collaboratively, it is possible to get quantitative measures about who has been responding to the particular marketing strategies that are in use.