MNB1601 NOTES

OPERATIONS MANAGEMENT

The operations function is that function of the business aimed at executing the transformation process.

The importance of operations management:

- It can reduce the cost of making products or offering services
- It can increase the revenue the business receives for offering its products and services to its customers/clients
- It can reduce the amount of investment (capital) needed to manufacture the type and quantity of products or to offer the service required/
- It can provide the impetus for new innovation by using its solid base of operational skills and knowledge to develop new products and services

Other reasons Op's Management are important to a business:

- Operations management can improve productivity
- Operations management can help a business to satisfy the needs of its customers/clients more effectively
- Operations management can be decisive for the general reputation of the business

Defining terms used in operations management:

- The operations function is that function in the business primarily aimed at the utilisation of resources to manufacture products or render services.
- Operations management involves operations managers' activities, decisions and responsibilities that tie in with the execution of the operations function.

Operation-management strategies and performance objectives:

All businesses formulate business objectives, and if a business intends surviving in the long term, consumers who are satisfied with the business's products or services should be a top-priority objective. Although there are numerous customer needs that can be reduced to 6 main elements:

- Higher quality
- Lower costs
- Shorter lead time (quicker manufacturing or provision of services)
- Greater adaptability (flexibility)
- Lower variability with regard to specifications (reliability)
- High level of service (better overall service).

With these 6 customer/client requirements as a basis, operations management performance objectives can be formulated to give the business an "operations-cased advantage" over other businesses. Operations management performance objectives must indicate the specific areas with the domain of the operations function that will be emphasised when products and/or services are produced or provided. The operations-management

performance objectives are formulated in such a way that they are applicable to both manufacturers and service providers. To acquire operations based advantages, the following 6 general operations-management performance objectives can be followed:

- Do things right the first time
- Do things cost effectively
- Do things fast
- Make changes quickly
- Do things right every time
- Do things better

Operations management guideline		**Positive result**
Do things right the first time		Higher quality
Do things cost effectively		Lower cost
Do things fast		Shorter lead time
Changing things quickly		Greater Adaptability
Do things right every time		Lower variability
Do things better		Better service

The transformation model:

The operations function is primarily concerned with using resources (inputs) to provide outputs by means of a transformation process. Therefore the transformation model comprises 3 main components: Inputs, the transformation process itself and outputs.

Inputs:

Inputs used in the transformation process comprise both the resources that are to be transformed (processed, changed or converted) and the resources required to make the transformation possible. The resources to be transformed include the following:

- Material
- Customers/clients
- Information

The resources required to make transformation possible include:

- Human Resources
- Equipment and facilities
- Technology

The Transformation Process:

The transformation process converts inputs to outputs. The nature of the process is determined by what input is predominantly being processed.

Outputs:

The ultimate goal of any transformation process is to transform inputs into outputs. Outputs assume the form of products or services.

Characteristics of products and services:

Products produced by manufacturer	**Services produced by service provider**
• Physically tangible and durable	• Intangible and perishable
• Output kept in stock	• Output not kept in stock
• Little customer contact	• Plenty of client contact
• Manufactured before use	• Provision and consumption simultaneous
• Long response time	• Short response time
• Local & International markets	• Mainly local markets
• Large production Facilities	• Small service-provision facility
• Capital-intensive production	• Labour intensive
• Quality easily measurable	• Quality difficult to measure

Different operations have different characteristics:

While the basic purpose of all operations is similar in that they transform inputs into outputs, the processes may differ fundamentally in 4 ways:

- The volume of output may differ (amount)
- The variety of the output may differ (range)
- The variation of output may differ (demand pattern)
- The visibility of output may differ (refers to how much of the operations activities the customers experience themselves or are exposed to)

The classification of process types for manufacturers:

In manufacturing the most common classification system classifies different operations processes according to the volume of output and the variety of products. According to the classification system 5 main categories are identified:

- **Project Processes**: Projects represent operational processes that are highly individual and unique, but that are normally tackled on a large scale. It can take several months or years to complete such projects (i.e. constructions projects, upgrading or building of airport, road, bridge etc.)
- **Jobbing Processes:** Jobbing normally represents operational processes conducted on a small scale with a low volume of output. The nature of the work is the same throughout, but the specific requirements differ from 1 task to the next. (Egg goldsmith manufacturing jewellery, each piece is usually unique)
- **Batch Processes** (job lots): In batch production a limited range of products are manufactured by the business and production occurs in batches. Similar to jobbing but doesn't have same degree of variety. i.e. batch production of domestic appliances such as kettles, toasters, irons etc.

- **Mass Processes**: Mass production is the production of products in high volume with relatively little variety. There is some variety in the product itself but the basic process of production is the same, repetitive in nature, largely predictable and easier to manage that jobbing and batch processes.
- **Continuous processes:** Continuous production is a step beyond mass production because the volumes are even greater but there is very little variety in the type of product. E.g. cement manufacturer PPS cement, ESKOM for electricity.

The classification of process types for service providers:

The same classification criteria used for manufacturers can be used for service providers . According to such a classification system 3 main categories can be identified:

- Professional Services: represent operational processes provided on a high client-contact basis, where the client is usually present within the service process for a considerable period of time. Contact often occurs on a one-to-one basis. Volume is usually low while variety of services offered high e.g. doctors, lawyers, dentists
- Service shops: Service shops represent operational processes where the characteristics of service provision fall between those of professional services and those of mass services. There is a fair amount of client contact & services are standardised to a degree e.g. Banks, hotels, shops etc
- Mass services: represent operational processes where many client transactions occur with limited client contact and nature of services provided is largely standardised e.g. post services, rail & transport services.

Operations Design

The nature of operations design entails two interdependent aspects:

- The design of products and services (product design)
- The design of operations product or services processes to manufacture or provide these products or services (process design)

The primary aim of operations design is to provide products and or services and processes that satisfy the needs of customers/clients in the best possible way.

The design of products and services:

Competitive advantage of good design:

If products are well designed, produces and provided so that the expectations of customers are met or exceeded then business's competitive positions will be reinforced through increased sales of these products/services.

The Components of products and services:

All products and services consist of 3 interdependent components: A concept, a package and a process.

The stages in the design of products and services:

- Concept generation
- The screening process
- Preliminary design
- Evaluation and improvement
- Prototype and final design

The design of operations processes

The design of supply networks

In the design of a particular operations process, it is important for the entire supply network to be taken into considerations, to determine the inputs for the specific operations process and the customer needs that have to be satisfied.

The layout and flow of manufacturing and service provisions facilities:

The layout of the operations facility determines the physical arrangement of the resources use dint eh transformation process. Layout also determines the way in which resources such as raw materials, information and customers flow through the transformation process. The layout of a manufacturing or service provision facility entails 3 steps:

1. Selecting the process type: For manufacturers – project, jobbing, batch, mass & continuous processes. For service providers – professional services, mass services and service shops.

2. Selecting the basic layout type: 4 basic layout types:

    - The fixed position layout (cannot be shifted)
    - The process layout (flexible-flow layout); similar processes grouped together into sections
    - The product layout (line-flow layout); different processes arranged in consecutive order
    - The cellular layout (hybrid layout); specific processes placed in a cell and arranged according to either a process or a product layout.

The application of process technology

Process technology refers to the machines, equipment and apparatus used in the transformation process to transform materials, information's and clients so that products can be manufactured or services provided.

Job design and work organisation

The way in which human resources are managed in a business has a fundamental effect on the effectiveness of the operations function.

Operations Planning and Control

The nature and operations planning and control

Operations planning and control focuses on all the activities required to put the operations process into action efficiently on a continuous basis so that products can be manufactured or services can be provided to meet the needs of customers. Reconciling the supply of products or services with the demand for them by means of planning and control activities occurs in 3 dimensions:

- Volume (quantity)
- Timing (when)
- Quality (conformity to clients expectations)

To reconcile the volume and timing dimensions with each other, 3 different but integrated activities are performed

- The loading of tasks
- The sequencing of tasks
- The scheduling of tasks

Capacity planning and control

The focus on capacity planning and control is on the provision of the manufacturing or service capacity of a particular operations process.

Capacity from an operations point of view is defined as the maximum level of value added activity over a period of time that the process can achieve under normal operating circumstances.

The nature of capacity planning and control:

Quantitative data on the expected demand and required capacity to satisfy this expected demand must be obtained by applying 3 steps:

1. The total demand and required capacity must be determined
2. Alternative capacity plans must be identified, 3 options available
   • A level-capacity plan in which capacity levels are kept constant and demand fluctuations are ignored
   • A chase-demand plan in which capacity levels are adjusted according to fluctuations in demand
   • A demand-management plan in which demand is adjusted to tie in with available capacity
3. The most suitable approach to capacity planning and control must be chosen

Techniques and methods during capacity planning and control

2 techniques:

- The moving-average demand-forecasting technique (based on actual demand data over preceding periods)

- Cumulative representations of demand and capacity (a method that can be used to evaluate the effect of different capacity plans graphically)

Inventory and supply-chain planning and control

Inventory from operations management perspective is defined as all stored resources required for the smooth functioning of the operations process.

Quality planning and control

Quality from an Operations management is defined in terms of what a customer expects of a particular product or service.

The aim of quality planning and control is to ensure that the products or services that are manufactured or provided conform to or satisfy design specifications.

The steps in quality planning and control:

6 steps:

- Defining the quality characteristics of the product or service. Quality characteristics that are often used include: Functionality, Appearance, Reliability, Durability, and Serviceability & Contact.
- Measuring the quality characteristics of the product or service.
- Setting standards for each quality characteristic of the product or service
- Controlling quality against the set standards, 3 important questions
    1. Where in operations process should one check to see if standards have been satisfied?
    2. Should each product/service be checked to determine whether the standards have been met?
    3. How should inspection be conducted?
- Identifying and rectifying the causes of poor quality
- Continually improving quality

Operations improvement

Different types of performance standards

- Historical performance standards
- Target performance standards
- Competitors' performance standards
- Absolute performance standards

Priorities for improvement

The needs of customers provide an indication of those performance areas of particular importance to them. Ops manager's objectives should reflect the preferences of its customers.

Approaches to improvement

- **Breakthrough improvement** (dramatic and large scale changes occur in the functioning of an operation process but not very regularly)

- **Continuous improvement** (more regular but smaller, incremental changes take place)

Failure prevention and recovery

Types of failures:

- Design failures
- Facility failures
- Staff failures
- Supplier failures
- Customer failures

Failure detection and analysis

Mechanisms to detect failures include process-monitoring, complaints and feedback questionnaires from customers.

Systems reliability improvement

The causes and consequences of failures should be prevented (redesigning products or services or the processes that manufacture or provide them)

Recovery of failures

When failures occur, recovery procedures and contingency plans should already have been devised and put in place to minimize the potential detrimental effects.

Total Quality Management

TQM can be defined as a management's philosophy that primarily aims to satisfy the needs and expectations of customers/clients by means of high-quality products or services, and that endeavors to shift the responsibility for quality from the operations-management function to the entire business.

TQM is aimed at:

- Meeting the needs and expectations of customers
- Covering all parts of the business regardless how small
- Making every employee quality conscious and holding them responsible for their contribution to the achievement to TQM
- Identifying and accounting for all costs of quality
- Doing things right the first time
- Developing and implementing systems and procedures for quality and improvement thereof
- Establishing a continuous process for improvement

Implementation of TQM

• Factors to be taken into account:

- Integration of TQM in the overall business strategy
- Top management's and employees' support and involvement
- Teamwork in the improvements initiatives
- Feedback on quality successes that have in fact been achieved
- Creation of quality awareness
- Training of the employees in quality techniques and methods

HUMAN RESOURCES MANAGEMENT

Human resources management and organization effectiveness

- Successful organization share human resources management attributes:
  - ✓ Participative style of management
  - ✓ Communication with all levels of employees
  - ✓ Promotion from within
  - ✓ Training of employees
  - ✓ Rewarding of good work
- Contribution of human resources or organization effectiveness:
  - ✓ Assisting everybody in organization to reach stated goals
  - ✓ Making efficient use of skills and abilities of workforce
  - ✓ Providing organization with well-trained motivated employees
  - ✓ Assisting in attainment of employee job satisfaction + self-actualization
  - ✓ Develop a quality of work life that makes employment in organization desirable
  - ✓ Assisting with maintenance of ethical policies and socially responsible behaviour
  - ✓ Managing change to mutual advantage of individual, groups, organization and public
  - ✓ Executing human resources functional activities in professional manner

Human resources planning

Process of using organization goals and strategy to forecast organization human resources needs in terms of finding, developing and keeping qualified workforce

- ✓ Identify work being done in business at present (job analysis + job description)
- ✓ Identify type of employee needed to do work (job specification)
- ✓ Identify number of employees needed in future (human resources planning and forecasting)

Job analysis

- ✓ Process describing and recording info about job behaviours and activities
- ✓ One method is observation by qualified job analyst
- ✓ Can be done for manual labour
- ✓ For administrative work – do interviewing

Job description

- ✓ Data collected put in writing = job description
- ✓ Must be easy readable

Job specification

- ✓ Is personal qualifications an employee must possess to perform duties and responsibilities depicted in job description
- ✓ Details the knowledge, skill, abilities, education and experience
- ✓ Can also include physical demand of job e.g. walking and standing

Human resources forecasting

Purpose is to balance human resources supply and human resources demand
Take into consideration:

- ✓ Economic growth
- ✓ New development in business
- ✓ Labour market

Human resources plan

To provide concrete guidelines and steps that indicate how business short, medium and long term human resources requirements can be provided for.

Finding qualified workers

Recruiting

To ensure that sufficient number of applicants apply for various jobs

Recruiting from inside

Internal recruiting

- To fill vacant position with existing staff
- Advantages:
  - ✓ Career planning becomes possible
  - ✓ Assessment of applicants is easier
  - ✓ because recruitment cost is low
- Disadvantages:
  - ✓ Business tends to stagnate
  - ✓ Staff at lower levels do not necessarily have abilities to fill senior positions
  - ✓ Can be a lot of personal competition

Recruitment from outside

External recruitment

- Advantages:
  - ✓ Active effort is made to get right person
  - ✓ Opportunity created to bring new ideas
- Disadvantages:
  - ✓ Recruiting costs are higher
  - ✓ It is risky – assessment of applicant can be wrong
  - ✓ Morale of existing personnel can be influenced

Recruitment procedure

- If internal recruitment ensure that relevant documentation is available
- External recruitment – right people must apply
- If too many apply – time consuming
- External recruitment – analysis of labour market NB!
- Labour market = social of demographical area where a organization draws its employees

Recruitment techniques

- Advertising
- Consultants and labour agencies
- Existing employees
- Personal approach
- Radio, TV, internet
- Recruiting agencies

Selection

- Can vary from short interview to intensive assessment
- Preliminary screening
- Intensive assessment:
  - ✓ Psychological testing
  - ✓ Diagnostic interviewing
- Final selection
- Placement and induction
- Induction process will achieve:
  - ✓ Introduce to colleagues
  - ✓ Explain business policy, procedures and rules
  - ✓ Inform about business history, products and services
  - ✓ Inform about practical arrangements e.g. payment
  - ✓ Inform about organization structure

Developing qualified workers

Human resources development

Human resources manager:

- ✓ Ensure company employs sufficient staff
- ✓ Creating opportunities for employees to make themselves more valuable

Distinguish between:

- ✓ Training –technical and management
- ✓ Development

- Training = provide employee with knowledge and skill needed to do particular job
- Development = long term focus on preparing for future work responsibilities
- Human resources development = systematic and planned activities designed by organization to provide its members with opportunities to learn necessary skills to meet current and future jobs

Development methods

Within work situation:

- ✓ Formally
- ✓ Informally

Outside work situation:

- ✓ Formally
- ✓ Informally

Performance appraisal

To determine in which aspect the employee has:

- ✓ performed exceptionally well
- ✓ complied with requirements for the job
- ✓ not complied with requirements of job

Also called:

- ✓ employee rating
- ✓ employee evaluation
- ✓ performance review
- ✓ performance evaluation
- ✓ results appraisal

- performance appraisal must be objective
- some provide methods to assess characteristics of employee
- least effective way – to compare employees
- new method 360° multisource rating
- feedback from various colleagues and constituencies received
- results of performance appraisal be used for:
  - ✓ provide basis for financial rewards
  - ✓ to determine promotion to higher level
  - ✓ to provide employee feedback on how well they are doing

Keeping qualified workers

- Refers to all forms of financial returns, tangible services and benefits they receive as part of employment relationship
- Important when drawing up policy:
  - ✓ How compensation should compare in general with labour market
  - ✓ Must be determined on cost-of-living adjustment
  - ✓ What form reward will take

Types of compensation

- Compensation is output an employee receives for input (work) he provides
- Direct compensation:
  - ✓ Monthly paid = salary
  - ✓ Daily / weekly = wage
  - ✓ Piece wage = compensated for amount of work her performs regardless of time it took
- Indirect compensation:
  - ✓ Benefits employees receive from membership to organization = fringe benefits
  - ✓ Leave
  - ✓ Insurance
  - ✓ Housing
  - ✓ Car
  - ✓ Linked to hierarchical level of employee

Reward:

- ✓ Salary increase
- ✓ Financial bonuses
- ✓ Paid holiday

Amount of compensation

- Make external comparisons e.g. salary survey
- Make internal comparisons = job evaluation
- Value of jobs must be compared in terms of demand it makes on employee
- Job evaluation – 2 methods:
  - ✓ Ranking all jobs in company
  - ✓ Factor comparison method – jobs are compared in terms of demands it makes on employee in terms of factors e.g. knowledge
  - ✓ Points are awarded for each factor = compensate factors
  - ✓ Total points determine job grade
- Job description – purpose 2 fold:
  - ✓ Form basis of job specification
  - ✓ Provide basis for job comparison

Motivating employees

Motivation in workplace

Determined by 3 things:

- ✓ Desire to do job (motivation)
- ✓ Capability to do job (ability)
- ✓ Resources to do job (work environment)

- Motivation = forces within a person that affect his direction, intensity and persistence of behaviour that is within control of a person
- Motivated employee is prepared to:
  - ✓ Exert a particular level of effort – intensity
  - ✓ For a certain amount of time – persistence
  - ✓ Toward a particular goal – direction
- Different approaches to motivation:
  - ✓ Content approach
  - ✓ Process approach
- Content = what actually motivates people (need theories)
- Process = actual process of "how" of motivation

Content approach to motivation

- **Abraham Maslow – hierarchy of needs**
  - ✓ Physiological needs
  - ✓ Security needs
  - ✓ Social – belonging needs
  - ✓ Esteem needs
  - ✓ Self-actualization needs

- **Clayton Alderfers – ERG theory**
  - ✓ Existence needs
  - ✓ Relatedness needs
  - ✓ Growth needs
- **Frederick Herzberg – 2 factor theory**
  - ✓ Maintenance (hygiene) factor
  - ✓ Motivational factor – growth factor
  - ✓ Internal motivation – based on motivators
  - ✓ External motivation – based on maintenance factors
- **David McClelland – learnt theory**
  - ✓ Needs are learnt and reinforced
  - ✓ Need for achievement
  - ✓ Need for power
  - ✓ Need for affiliation

Implications of content theories:

- ✓ Theories suggest that needs change
- ✓ Management need to balance power need with affiliation need
- ✓ Needs may be unconscious

Process approach to motivation

- **Expectancy theory - Victor Vroom**
- How much we want something
- How likely we think we are to get it
- 4 assumptions:
  - ✓ Behaviour is combination of forces controlled by individual and environment
  - ✓ People make decisions about own behaviour in organization
  - ✓ Diff people diff goals
  - ✓ People will act in a certain way
- 3 key concepts:
  - ✓ Expectancy
  - ✓ Instrumentality
  - ✓ Valence (desirability)
- **Equity theory and organization justice – Stacey Adams**
- Employee compare efforts with those of other employees
- People are motivated by desire to be treated equitably
- Organizational justice:
  - ✓ Distributive justice
  - ✓ Procedural justice
  - ✓ Interactional justice

Practical implications of equity theory:

- ✓ Employee is motivated to correct situation when perception of fairness is offended
- ✓ Emphasize to pay attention to what employee think is fair
- ✓ Management must explain rationale behind decisions
- ✓ Employee are treated fair if they appeal to certain decisions
- ✓ Employee more likely to accept change if they think it is fair
- ✓ Teamwork promoted when employee are treated fair
- ✓ Management need to entrench values such as honesty etc.

- **Goal setting theory and feedback**
- Built on assumption, all things being equal, performance of employee will improve if they strive toward a definite goal
- Thrust is that more difficult the goal is the higher the level of performance is if employee are committed to goals
- Goals – inform employee about performance and expectations
- Feedback – provides info to adjust effort
- Effective feedback:
  - ✓ Give feedback immediately
  - ✓ Evaluations should be descriptive
  - ✓ Focus on behaviour not personality
  - ✓ Should be specific not general
  - ✓ Should be directed at behaviour that can be changed
  - ✓ Development activities should be agreed upon
- Self-efficacy – Albert Bandura
- Refers to belief in one's capacity to perform a task or to adhere to goal
- Cycle:
  - ✓ Setting challenging goals
  - ✓ Monitoring success
  - ✓ Taking action to lower discrepancies
  - ✓ Setting new goals
- Can be increased by following approaches:
  - ✓ Provide guidance and support to employee
  - ✓ Provide successful role models
  - ✓ Be a targeted cheer leader
  - ✓ Reduce stress environment

Implication of process approaches

- ✓ Intention plays a key role in motivated behaviour
- ✓ Feedback vital importance
- ✓ All have a rational element
- ✓ Can induce self-assessment
- ✓ Non-rational component also important

<u>Employee motivational strategies</u>

- Job design:
  - ✓ Job rotation
  - ✓ Job enrichment
- Employee involvement in programmes as participative management and quality circles
- Management by objectives
- Intrapreneurial incentives
- Training and education
- Employee recognition programs
- Empowerment programs
- Reward systems
- Career management

PURCHASING AND SUPPLY MANAGEMENT.

Buyers' expertise can improve:
- Progressiveness
- Profitability
- Productivity

Buyers need to be aware of market trends, seasons and state of the market

Purpose of purchasing and supply function:
- To provide right material services and equipment
- At reasonable price
- Satisfy quality requirements
- Received in correct quantities
- At right time right place

Purchasing supply function should:

- Select suppliers
- Purchase and arrange for transport to business
- Decide what price to accept
- Determine quality and quantity of materials
- Expedite and receive materials
- Control warehousing and inventory holding
- Determine timing of purchases

Importance of purchasing and supply

1. Greatest expenditure of business
- Purchasing cost is business greatest expense
- Profit = favourable difference between income and expenditure

2. Inventory holding
- Stock is held to prevent disruptions in transformation process
- Aim is to keep inventory levels as low as possible without interrupting operational process
- Reason – large sums of capital is tied up in inventory
- Warehousing 10 – 25% of total investment
- Includes:
    - ✓ Financing warehouse
    - ✓ Warehouse staff
    - ✓ Insurance and obsolescence

3. Profit leverage

• If purchasing cost constitutes a major portion of total cost of business a saving cost in purchasinghas greater profit potential than a similar increase in sales
• Usually greater profit potential in commercial organization than in manufacturing organization

4. Contribution to marketing of products

• By purchasing material at right quality and price and time final products can be available in rightquantities
• Retail buyer has greater influence on marketing of merchandise
• Successful marketing = availability of right products, right time, in right quantities

Management task of purchasing and supply

Purchasing and supply planning

- Formulating of objective which purchasing and supply strive to reach by particular future period
- Plans should include optimal application of resources
- 3 levels are **strategic, tactical and operational.**

Strategic level

- ✓ Supplier alliances
- ✓ Supply development
- ✓ Supply chain integration
- ✓ Long term planning
- ✓ Availability forecasting
- ✓ Policy formulation
- ✓ In / out sourcing decisions

Tactical level

- ✓ Systems integration
- ✓ Negotiation
- ✓ Interface development
- ✓ Human resource development
- ✓ Total quality management
- ✓ Contracting
- ✓ Cos reduction techniques

Operational level

- ✓ Communication with supplier operational staff
- ✓ Expediting
- ✓ File and system maintenance
- ✓ Enquiries and quotations
- ✓ Pricing
- ✓ Returns and recycling

On-going supply and purchasing function

- **4 main issues to be addressed**:
  - ✓ Place of purchasing and supply in organization structure
  - ✓ Internal organization of purchasing and supply function
  - ✓ Co-ordination with other functional management areas
  - ✓ Cross functional teams

Place in organization structure

- **Affected by 2 elements:**
  - ✓ Centralization or decentralization
  - ✓ Hierarchical level of purchasing and supply in organization structure

- **Organization with head office and various branches has a few options:**
  - ✓ Centralized purchasing and supply
  - ✓ Each branch does its own purchasing
  - ✓ Combination of centralized and decentralized

- **Centralized purchasing and supply**
  - ✓ Standardization of purchasing and supply procedures possible
  - ✓ Greater volume of material purchased from one supplier is more cost effective
  - ✓ Better discounts for volume orders
  - ✓ Enables specialization

- **Decentralized purchasing and supply**
  - ✓ Business compromising different geographical areas
  - ✓ Also if plants have different activities
  - ✓ Buyers have closer contact with users

Hierarchical level of purchasing and supply in organization structure

- Value of purchased material in relation to total expenditure of business
- Situation in supplier market
- Size of business
- Nature of material purchased and spec knowledge and skills of buyers
- Top management perception

Internal organizing of purchasing and supply

- Informal structure
- Buyer purchase anything that is on his desk
- Get quotes, buy and receive
- Specialist groups
- Certain people order certain things
- Get to know products very well
- Can bring cost savings to company
- Or certain people work with certain suppliers
- They can build long term relationships with suppliers

Co-ordination with other functional management areas

- 3 levels
  - ✓ Purchasing and supply function must be co-ordinated internally
  - ✓ Purchasing environment must be co-ordinated with purchasing and supply activites

- ✓ Co-ordinated with other functional management areas e.g. finances, marketing

- To improve co-ordination internally:
  - ✓ Open communication
  - ✓ Conscious motivation
  - ✓ Standardization of specifications, procedures and documentation
    - ✓ JIT and MRP plan and control inventory

1.2 **Cross functional sourcing teams**

- **Purchaser co-operates on team and colleagues of other functional management areas to perform tasks which includes**:
  - ✓ Supplier selection
  - ✓ Negotiating corporate wide purchasing agreements
  - ✓ Develop cost reduction strategies
  - ✓ Develop sourcing strategies
  - ✓ Develop suppliers
  - ✓ Evaluate suppliers performance

- **Objective to use cross functional teams:**
  - ✓ Obtain wide perspective of problems
  - ✓ Stimulate innovative thinking
  - ✓ Obtain best value for organization and customers

Control in purchasing and supply

- Questionnaire used
- Includes the following aspects:
  - ✓ Leadership shown in introduction of new ideas
  - ✓ Percentage of purchasing contracts established
  - ✓ Knowledge and skills to lead purchasing and supply section
  - ✓ Relationships established with strategic suppliers
  - ✓ Adequacy of performance appraisal
  - ✓ Contribution to cross functional teams
  - ✓ Role in establishment and management of supply chains
  - ✓ Effectiveness of use of total purchasing leverage of firm
  - ✓ Appropriateness of purchasing policies, procedures and practices

Assessment of purchasing and supply activities

- ✓ Price proficiency
- ✓ Supplier performance
- ✓ Timelines
- ✓ Cost saving
- ✓ Workload
- ✓ Purchasing cost
- ✓ Inventory holding
- ✓ Relationship performance with suppliers
- ✓ Relationship with other functional management areas

Purchasing process and activities

Purchasing process

- ✓ Development and description of a need

- ✓ Choice of supplier
- ✓ Research on prices and availability
- ✓ Issuing the order and concluding the contract
- ✓ Follow up and expediting
- ✓ Receipts, inspection and distribution
- ✓ Handling errors and discrepancies
- ✓ Paying for the order
- ✓ Closing the order

Quality decisions as a purchasing and supply activity

Role of quality in purchasing

- 4 main factors in purchasing and supply
  - ✓ Quality
  - ✓ Supplier service
  - ✓ Delivery
  - ✓ Price
- Quality determines amount of suppliers, high quality will only be available form some suppliers
- Quality also influences inventory holding
- Smaller amounts need to kept in inventory
- High quality is necessary for JIT and MRP inventory systems
- Quality purchased products rest on considerations:
  - ✓ Determining right quality for given goal
  - ✓ Describing quality so that buyer and seller understand
  - ✓ Controlling quality to ensure requirements are met

Determining right quality

- Right quality is that quality that is purchased at lowest price which satisfies a specific need and performs the function for which it has been purchased
- A buyer should have the right to question technical requirements or to request that specifications be reconsidered on strength of commercial considerations
- End user / marketing function also input on suitable quality
- Important for marketing and public relations – quality influence image of organization

Description of quality

- Refers to measureable qualities a condition or characteristics of materials expressed according to grade, class, brand of specifications
- 3 methods to describe quality:
  - ✓ Specifications
  - ✓ Standardization
  - ✓ Market grades, brands, SABS

Control of quality

- Poor materials interrupt manufacturing process and have detrimental effect on final product
- Reduce satisfaction of end user
- Inspection = normal process of quality control
- If supplier give high quality materials can negotiate supplier certification agreement

- Materials and process is inspected for a period of time and then supplier is certified and becomes responsible for quality assurance

Deciding on purchasing and supply quantities

Need for inventory holding

- Can be able to buy exact quantity of materials required at certain time if following criteria is met:
  - ✓ Operations function is 100% sure of quantity of materials to be used in manufacturing process
  - ✓ Marketing was 100% sure of how many products will be sold
  - ✓ There were no supply problems in supplier market
  - ✓ Incoming material completely satisfied quality requirements
- Above situation does not exist
- Many work on estimates
- Supply problems can cause organization to keep inventory
- Inventory ties up working capital
- To limit inventory holding:
  - ✓ JIT
  - ✓ MRP
  - ✓ Enterprise resource planning ERP
  - ✓ Efficient consumer response ECR
  - ✓ Automatic replenishment AR
  - ✓ Quick response QR
  - ✓ E-procurement
- Reasons for inventory holding:
  - ✓ Ensure that operations process is not interrupted
  - ✓ Allows business to utilize cost savings through longer production runs and volume discounts
- Disadvantages of too much inventory
  - ✓ Operating capital is tied up – opportunity and interest cost
  - ✓ Loses in term of depreciation, obsolescence, theft, damage
  - ✓ Cost in terms of storage, space, warehouse staff, insurance
- Disadvantage of keep to little inventory
  - ✓ Higher unit prices due to small orders
  - ✓ More urgent orders and higher transport costs
  - ✓ Strained relationships with suppliers
  - ✓ Cost of production interruptions
  - ✓ Strained relationships with users
  - ✓ Lost sales due to empty shelves in retail organization
  - ✓ Negative impact on business image

Inventory costs

- Inventory carrying costs = costs involved in keeping inventory
- Includes the following:
  - ✓ Cost of storage
  - ✓ Salaries of warehouse staff
  - ✓ Insurance
  - ✓ Property tax
  - ✓ Obsolescence

- ✓ Wear and tear
- ✓ Theft
- ✓ Interest charges

- ✓ Opportunity costs

- Inventory – ordering costs = cost of placing an order
  - ✓ Salaries of purchasing and supply personnel
  - ✓ Stationary
  - ✓ Telephone
  - ✓ E-procurement
  - ✓ Postage
- Total inventory cost = sum of inventory carrying cost and inventory ordering cost
- Ordering cost lower can carrying cost higher as order quantities increase
- Ordering cost higher can carrying cost lower as order quantities decrease
- Number of units apposite lowest total inventory cost = economic order quantity EOQ

Inventory control systems

Fixed order quantities

- Fixed quantity is ordered
- Same quantity is ordered every time

Cyclical ordering system

- Quantity of item is reviewed at fixed intervals
- Supplemented by ordering enough to bring inventory to maximum

Materials requirement planning MRP

- Computer assisted system
- Keep inventory as low as possible
- Suppliers must be reliable with deliveries

Just in time JIT

- Production / operations scheduling system
- Eliminates holding of inventory
- Suppliers must deliver right quality just in time
- Only materials used in operations can be ordered JIT

Quick response QR and automatic replenishing AR

- QR – where manufacturer strives to deliver products to retail in exact quantities on continuous basis with minimum lead times – minimum inventory levels
- QR is retail version of JIT
- AR – integral part of QR program
- AR – exchange relationship where supplier replenishes inventory on basis of actual usage

Efficient consumer response ECR

- ECR developed for grocery industry

- Based on same principles as QR
- Timely, accurate paperless flow of information
- Objective is to reduce cycle time in supply chain

Selection and management of supplies

Importance of selecting suppliers

- Choice of supplier influences:
  - ✓ Prices
  - ✓ Reliable quality
  - ✓ Timely deliveries
  - ✓ Technical support
  - ✓ Good after sales support
- Long term relationship with suppliers is important
- Important components:
  - ✓ Honesty
  - ✓ Fairness
  - ✓ Frankness

Selection process

- On-going process
- Existing suppliers constantly reconsidered
- History of past performance is important
- Selection determined by:
  - ✓ Scope of transaction
  - ✓ Availability of materials
  - ✓ Strategic value of materials
  - ✓ Whether standard or custom made
- Set up a list taking into account:
  - ✓ Location
  - ✓ Progressiveness
  - ✓ General reputation
  - ✓ Financial ability
  - ✓ Technical ability
- Suppliers are then requested to quote / negotiate
- Aim is to obtain best value for money
- Final choice based on:
  - ✓ Past performance
  - ✓ Quality
  - ✓ Price
  - ✓ Delivery
  - ✓ Technical support
  - ✓ Reliability
  - ✓ Progressiveness
- Supplier evaluation is important:
  - ✓ Ineffective unreliable suppliers are identified
  - ✓ Improvement of supplier performance
  - ✓ Guide for developing suppliers

Developing suppliers

- Suppliers developed for:
  - ✓ Black empowerment
  - ✓ Improve performance as a result of supplier appraisals
  - ✓ If materials do not exist in local market

Long term relationships with suppliers

- Nature of relationships varies
- Some distant formal, some close personal
- Small involvement in stand product suppliers
- Big involvement in strategic scarce materials
- Alliance or partnership high involvement relationship
- Attributes:
  - ✓ Trust
  - ✓ Co-operation
  - ✓ Interdependence
  - ✓ Joint quality improvement efforts
  - ✓ Information sharing
  - ✓ Risk and benefit sharing
  - ✓ Joint problem solving

Pricing decisions

Best price

- Price traditionally regarded ad decisive factor in rewarding orders
- Low price – high costs in other areas
- E.g. risk attached to low quality and high inventory
- Right price not necessarily the lowest one
- Final cost should be decisive factor in rewarding orders
- Price should be reasonable and enable manufacturer to market product competitively
- Price should be fair to purchasing organization and supplier

Price determination

- Methods use depends on nature of materials and value of transaction
- Published price lists – used for standard items
- Tenders, quotations, bidding
- Quotations are quick and easy
- Tenders – drawn out process, has to be followed by the letter
- Custom made materials with high monetary value

Timing of purchases

Right time to buy

- Time at which purchases one made often determines price paid
- Aims of buying at right time is:
  - ✓ To ensure that business is supplied on on-going basis
  - ✓ Reduce risk of price fluctuations
  - ✓ Keep inventory holding at optimum level

Factors influencing purchase scheduling

Internal:

- ✓ Business policy
- ✓ Availability of funds
- ✓ Changes in marketing and operations
- ✓ Physical facilities – storage

External:

- ✓ Market conditions
- ✓ Government regulations
- ✓ Lead times
- ✓ Reliability of suppliers
- ✓ Government restriction

FINANCIAL MANAGEMENT

- Business needs funds – capital to obtain required assets
- People or institutions who make funds available loose right to use the funds
- They stand a chance to loose funds
- They expect compensation when organization generate funds
- Financial function concerned with HOW of funds
- Acquisition of funds = financing
- Application of funds for acquisition of assets = investment
- To make highest contribution to objective of organization by:
  - ✓ Financial analysis, reporting, planning and control
  - ✓ Management of application of funds
  - ✓ Management of acquisition of funds

Concepts in financial management

- Balance sheet- overall grasp of financial position of a business
- Assets:
  - ✓ Fixed assets – land and buildings
  - ✓ Current assets – cash in bank
- Liability side – nature and extent of interest in assets
- Shows financing / capital structure of business
- Subdivided in 2:
  - ✓ Term for which funds were made available
  - ✓ Source from which funds have been obtained

Liability side will have the following details:

- Long term funds – non-current liabilities, shareholders interest and long term debt
- Shareholders interest
  - ✓ Owners' equity
  - ✓ Preference share capital
- Short term funds – current liabilities, debts and credits payable in one year, eg bank overdrafts and creditors

Capital

- Accrued power of disposal over the products used by a business to generate monetary return
- Monetary value of its assets at a given time
- Capital needed for investment in fixed assets – need fixed capital
- Capital needed for investment in current assets – need working capital
- Business permanent need for certain minimum portion of working capital

Income

- Receipts resulting from sales of its products
- Income = units sold x price per unit
- Can also be from interest earned

Costs

- Monetary value sacrificed in production of product produced for purpose of resale
- Direct costs
- Indirect costs
- Overhead expenses
- Fixed costs
- Variable costs

Fixed costs

- Portion of total cost that remains unchanged regardless of increase / decrease in quantity of products produced

Variable costs

- Total cost that changes according to a change in volume produced

Total cost

- Total fixed cost and total variable cost incurred in production of products

Profit

- Favourable difference between income earned during specific period and cost incurred to earn that income
- Loss results when costs exceeds the income
- Profit or loss = income – cost

Income statement

- Annual financial statement
- Manner in which profit / loss for specific period was arrived at and has been distributed
- Statement of financial performance

Objective and fundamental principles of financial management

- Long term objective = to increase value of business
- Can be done by:
  - ✓ Investing in assets that will add value to business
  - ✓ Keeping the cost of capital as low as possible
- Short term objective = ensure profitability, liquidity and solvency
- Profitability = ability to generate income that exceeds cost
- Liquidity = satisfy short term obligations as they become due
- Solvency = extent to which assets exceed liabilities
- Financial management based on 3 principles:
  - ✓ Risk return principle
  - ✓ Cost benefit principle
  - ✓ Time value of money principle

Risk return principle

- Profitability that actual result of decision may deviate from planned end result with an associated financial loss
- Risk is measurable by means of statistical techniques
- Trade-off between risk and return

Cost benefit principle

- To make analysis of total cost and total benefits and ensure that benefits exceed cost

Time value of money principle

- Increase the value of money by earning interest

Cost – volume – profit relationships

- Profitability determined by:
  - ✓ Unit selling price of product
  - ✓ Costs of product
  - ✓ Level of activity of business
- Break even analysis = total costs is equal to total income

Time value of money

- Time value of money bears a direct relation to opportunity of earning interest on investment
- Opportunity rate of return on investment
- Compounding – process of calculating future values
- Discounting – process of calculating present values

Future value of single amount

- Determined with compounding
- Interest is added to investment

Present value

Present value of single amount

- Based on principle that the value of money is affected by timing of recipients or disbursements
- Rate of return that would be forgone by not utilizing the investment opportunity
- Discounting process is reciprocal of compounding process
- Important implications of time value money:
  - ✓ Inflow must be accelerated
  - ✓ Outflow should be delayed
  - ✓ Manage inventory as optimally as possible

Financial analysis, planning and control

Financial analysis

- To monitor financial position of organization
- To limit risk of financial failure
- To help with financial analysis keep following in mind:
  - ✓ Income statement
  - ✓ Balance sheet
  - ✓ Funds flow statement
  - ✓ Financial ratios

Flow of funds in business

- Business has to make optimum use of limited funds to achieve its objective

Funds flow statement

- Helps with analysis of changes in financial position of business between 2 consecutive balance sheet dates
- Reflects net effect of all transactions for specific period
- 2 approaches in dividing up funds flow statement
- According to changes in cash position, including current bank account
- Analysis of funds flow statement advantages:
  - ✓ Indication of whether cash dividends are justified in terms of cash generated
  - ✓ How growth in fixed assets has been financed
  - ✓ Indication of possible imbalances in application of funds
  - ✓ Helps analyse financing methods of business

Financial ratios

- Liquidity ratio
- Current ratio
- Acid test ratio
- Solving ratio
- Profitability, rate of return or yield ratio
- Gross profit margin
- Net profit margin
- Return of total capital
- Return on shareholders' interest

- Return on owners' equity
- Measures of economic value
- Economic value added EVA
- Market value added

Financial planning and control

- Done by means of a budget
- Formal written plan of future action
- Expressed in monetary terms
- To implement strategy or organization
- To achieve goals with limited resources
- Also used for control purposes

Focal points of budgets in control system

- Control systems devised to ensure that specified strategic business functions is carried out properly
- Allocated to responsibility centres:
- Responsibility assigned to:
  - ✓ Income
  - ✓ Cost
  - ✓ Profit / investment
- Income centre
  - ✓ Outputs are measured in monetary terms
- Cost centre
  - ✓ Inputs are measured in monetary terms
- Profit centre
  - ✓ Measured by difference between inputs and outputs

Integrated system for manufacturer business

Operating budget

- Cost budget
  - ✓ Manufacturing cost budget
  - ✓ Discretionary cost budget
- Income budget
- Profit plan / profit budget

Financial budget

- 2 major purposes:
  - ✓ Verify viability of operational planning
  - ✓ Reveal financial actions to be taken to make execution or operating plans of business will affect future financial actions and condition
- Capital expenditure budget = expected future capital investment in physical facilities
- Cash budget indicates:
  - ✓ Extent, time and sources of expected cash inflows
  - ✓ Extent, time and purposes of expected cash inflows
  - ✓ Expected availability of cash in comparison with expected need for it.

- Financing budget = developed to assure the business of availability of funds to meet the budgeted shortfalls of income relative to expenses in short term, and to schedule medium and long term borrowing and financing
- Budgeted balance sheet = to project how financial position of business will look like at end of budget period.

Traditional budgeting

- Using actual income and expenditure of previous year as basis and making adjustments for expected changes

Zero based budgeting

- Look at activities afresh on annual basis
- Historical results are not used
- Leads to better prioritization of resource allocation and more efficient business
- Demoralize managers that have to justify their existence on annual basis

Balanced scorecard approach

- Introduced by Kaplan and Norton
- Align department budget with organization vision and mission
- Strategy implemented from 4 perspectives:
  - ✓ Financial
  - ✓ Customers
  - ✓ Internal processes
  - ✓ Learning and growth

Assessment management – management of current assets

- Current assets include:
  - ✓ Cash
  - ✓ Marketable securities
  - ✓ Debtors
  - ✓ Inventory
- Over investment in current assets means a low degree of risk
- Causes of profits to be less than maximum because of:
  - ✓ Cost associated with capital investment
  - ✓ Because of income forgone
- Under investment in current assets increases risk of cash and inventory shortages, also decrease in opportunity cost

Management of cash and marketable securities

- Cash is money in petty cash drawers
- Costs of handling cash:
  - ✓ Loss of interest
  - ✓ Loss of purchasing power
- Cost of little or no cash:
  - ✓ Loss of goodwill
  - ✓ Loss of opportunities
  - ✓ Inability to claim discounts
  - ✓ Cost of borrowing

- ✓ Transaction motive
- ✓ Precautionary motive
- ✓ Speculative motive

Cash budget

- Cash receipts
- Cash disbursements
- Net changes in cash
- Serves as a basis for determining cash needs of a business and indicates when bridging finance will be required

Cash cycle

- Investing cash in raw materials
- Converting raw materials to finished products
- Selling finished products on credit
- Ending cycle by collecting cash

Management of debtors

- Debtors arise when selling on credit to clients
- Debtors have to settle account in given period
- Credit granted to individual = consumer credit
- Credit sales increase total sales and income
- Balance between amount of credit sales and size of debtor accounts
- 3 important facets:
  - ✓ Credit policy
  - ✓ Credit terms – credit period and discounts for early payments
  - ✓ Collection policy – guidelines for collection
- Realistic credit standards 4 C's
  - ✓ Character
  - ✓ Capacity
  - ✓ Capital
  - ✓ Conditions
- Cost of granting debt:
  - ✓ Loss of interest
  - ✓ Cost associated with determining credit worthiness
  - ✓ Administration and record keeping costs
  - ✓ Bad debts

Management of stock

- Includes:
  - ✓ Raw materials
  - ✓ Auxiliary materials
  - ✓ Work in progress
  - ✓ Semi-finished products
  - ✓ Trading stock
- Represent a considerable portion of investment in working capital
- Conflict between profit objective and operation objective
- Costs of handling inventory stock are:
  - ✓ Loss of interest

- ✓ Storage cost
- ✓ Insurance cost
- ✓ Obsolescence

- Cost of holding little or no inventory:
  - ✓ Loss of customer goodwill
  - ✓ Production interruption and dislocation
  - ✓ Loss of flexibility
  - ✓ Reorder costs

Asset management – long term investment decisions and capital budgeting

- Capital investment involves use of funds to acquire fixed assets such as land and buildings
- Benefits accrue over period longer than 1 year
- Long term investments determine type, size and composition of fixed costs
- Importance of capital investment:
  - ✓ Relative magnitude of amounts involved
  - ✓ Long term nature of capital investment decisions
  - ✓ Strategic nature of capital investment projects

Evaluation of investment projects

- Basic principles is cost benefit analysis
- Benefits and costs occur at different times
- Time value of money should be considered

Cash flow concepts

- 3 cash flow components for capital – budgeting
  - ✓ Initial investment
  - ✓ Expected annual cash flow over life of project
  - ✓ Expected terminal cash flow related to termination of project

- Initial investment
  - ✓ Net cash flow outflow of commencement of project at time usually acquisition of fixed assets and required for current assets

- Annual cash flows
  - ✓ Net cash flows after tax that occur at any point during life of project minus cash outflow for the year

- Life of projects (in period of years)
  - ✓ Economic life of project
  - ✓ Determined by physical, technological and economic factors

- Terminal cash flow
  - ✓ Expected cash flow after tax which is revealed to termination of project

Net present value NPV and internal rate of return IRR

NPV and IRR discounted cash flow
Application of NPV involves:

- Forecasting:
  - ✓ Initial investment
  - ✓ Annual cash flow
  - ✓ Terminal cash flow
- Deciding on appropriate discount rate
- Calculating present values above 3 components
- Accepting all projects with positive NPV

Risk and uncertainty

- Limitations are that it does not take risk into account
- Risk = any deviation from expected outcome
- Uncertainty = unable to id certain variables and unable to assess likelihood of their occurrence
- Sensitivity analysis take risk into account

Financing

- Entails making decisions about:
  - ✓ Types of finance
  - ✓ Sources of finance

Financial markets

- At any point a financial system consists of those that have a surplus of money and those with shortage
- Growing business requires funds for new investment or to expand production
- Financial markets is a channel where “savers” make their money available to those who have a shortage thereof
- Financial institutions act as intermediaries – financial intermediation
- It is process where financial institutions pool money and make it available to business
- The saver who invests in a business is called financer
- Financer receives an assets or financial claims in exchange for his money
- Financial claims can be:
  - ✓ Saving and Cheque call accounts
  - ✓ Fixed deposits
  - ✓ Debentures
  - ✓ Ordinary preferred shares

Primary and secondary markets

- New issues a financial claims are referred to as issues on the primary market
- Trading of securities after they have been issued takes place in secondary market
- Saver who needs money can trade claim of secondary market
- JSE e.g. of secondary market
- Tradability of securities ensure that savers continue to invest

Money and capital markets

- Money market is market for financial instruments with a short term maturity
- Funds are borrowed and lent overnight or for months
- Funds required for long term investment are raised and traded by investors on capital market

Types of institutions

Financial institutions:

- Deposit taking institutions:
  - ✓ SA reserve bank
  - ✓ Land and agricultural bank
  - ✓ Corporation for public deposits
  - ✓ Private sector banks
  - ✓ Post office savings bank
- Non-deposit taking institutions:
  - ✓ Public sector – public investment commissioners
  - ✓ Private sector – life assurers, pension and provident fund, short term insurers, trusts
  - ✓ Other institutions – industrial development corporation

Short term financing

- Trade credit
- Accruals
- Bank overdrafts
- Factoring

Trade credit

- Mainly in term of supplied credit
- Supplier does not take payment when prod are purchased
- To ensure payment supplier after offer rebate for early payment
- Has the following advantages:
  - ✓ It is readily available for business that pay regularly
  - ✓ It is informal
  - ✓ More flexible than other forms of short term financing

Accruals

- Most common expenses accrued is wages and taxes
- Accrued tax is also from of financing
- Accruals have no associated cost

Bank overdrafts

- Arrangement with bank that allows business to make payments from Cheque account in excess of balance of account
- Purpose is to bridge gap between cash income and cash expenses
- Usually reviewed annually
- Interest charged daily
- It is repayable on demand – bank can cancel at any time

- Flexible form of short term financing

Debtor finance

- Consist of factoring and invoice discounting
- Sale of debtors to a debt financing company – invoicing discounting
- This company then converts credit sales into cash sales injecting funds that were tied up as working capital
- Factoring = financier also undertakes to collect debt
- The financier to whom the debt is sold = factor
- 2 types:
  - ✓ Non-resource factoring
  - ✓ Resource factoring
- Non resource factoring – factor buys debtors outright and bears the risk of bad debts
- Resource factoring – seller guarantees that debts are recoverable
- Factoring has the following advantages:
  - ✓ Cost of debtor admin is transferred to factor
  - ✓ Turnover of current assets increased and less capital is required to finance debtors
  - ✓ Liquidity improves
  - ✓ More cash available for other purposes

Short term financing decisions

Cost of short term financing usually lower than long term financing
3 approaches:

- Matching approach:
  - ✓ Hedging approach
  - ✓ Matching the period for which the finance is obtained with the expected life of asset
  - ✓ Fixed assets are financed with long term financing
- Aggressive approach
  - ✓ Uses short term financing that is needed for matching approach
  - ✓ Permanent current assets are partially financed with short term funds
- Conservative approach
  - ✓ Uses more long term funds than matching approach
  - ✓ Conservative because it used long term funds that are less risky

Long term financing

Shareholders interest

- Owners' equity
- Preference shareholder capital

Owners' equity

- Consists of funds made directly available by legal owners in terms of share capital
- As well as indirect contributions in terms of profit retention as reserves and undistributed profits

Ordinary share

- Shareholders are true owners of business
- Shareholders receive share certificates in exchange
- 2 types or ordinary shares:
  - ✓ Par value shares – same value
  - ✓ Non par value shares – value differ
- Co-owner of business has a claim to profits
- Characteristics of ordinary share:
  - ✓ Liability of ordinary share is limited to amount they contributed to business
  - ✓ If business is liquidated they lose their shares
  - ✓ May not be liable for debt
  - ✓ Shareholders have no certainty that money paid for share will be recouped, if depends on success of business
  - ✓ Ordinary shares in a listed company can be traded
  - ✓ Ordinary shareholders are owners of the company
  - ✓ Can vote at general meetings
  - ✓ Voting in proportion to shareholding
  - ✓ Business has not obligation to reward ordinary shareholders in the form of dividends for their investment shares
  - ✓ Share capital is available to company for unlimited time
- Advantages of ordinary shares:
  - ✓ No risk involved because payments of dividends are not compulsory
  - ✓ Additional ordinary shares serves as security for attracting capital
- Retained profits = reserves and undistributed profits
- Advantages:
  - ✓ No issue costs are involved – it is cheaper than using additional ordinary shares
  - ✓ Capital is immediately available
  - ✓ Lends flexibility to capital structure
  - ✓ No control implications
  - ✓ Serves as alternative form of financing
  - ✓ Entails no interest or redemption obligations

Preference shareholders capital

- Falls somewhere between debentures and ordinary shares
- 2 types:
  - ✓ Ordinary preference share
  - ✓ Cumulative preference share
- Ordinary preference shareholders forfeit a dividend if directors decide not to declare one in a particular year
- Cumulative preference shareholders retain the right to receive an arrear dividend in following year
- Preference share has following characteristics:
  - ✓ It has preferential claim over ordinary
  - ✓ It has preferential claim over ordinary shares on profit after tax
  - ✓ It has preferential claim over ordinary shares on assets of business in case of liquidation
  - ✓ Term of availability in unlimited
  - ✓ Authority can vary from full voting to no voting at all
- From viewpoint of business preference shares are cheaper than ordinary shares

Long term debt

- Debt that is repayable in a year or more
- Can be obtained by:
  - ✓ Loan
  - ✓ Credit
- Loan is a contract where borrower undertakes to make interest payment at specific time to lender
- To redeem total amount over a specific period of time
- Supplier of credit provides business (receiver of credit) with power of disposal over an asset and
- receives extended payments in return, principal sum + interest
- Debentures fixed rate of interest
- Mortgages – fluctuate – variable interest
- In case of unsecured debt creditor does not have preferential claim on assets of business

Forms of long term debt

- Loans
- Financial leasing

Loans

Debentures

- Most common form of long term debt
- Certificate issued to lender
- Certificate is tradable
- Fixed interest rate
- Available over specified term

Bonds

- Secured loans
- Issued with fixed assets such as fixed property

Registered term loans

- Unsecured loans
- Not freely negotiable

Loans have advantages:

- Costs are limited, they are defined by loan interest value
- Interest payment are deductible from tax
- Control of owners usually not influenced by issue of loans
- Loans do not dilute earnings of ordinary shares

Financial leasing

- Right to use an asset, legally owned by leaser in exchange for specified rental period
- Financial leasing gives the lessee the opportunity to own asset at the end of the term

- 2 terms:
  - ✓ Direct financial leasing
  - ✓ Leaseback agreements
- Direct financial leasing
  - ✓ Motor vehicles computers
  - ✓ Value of asset and interest is paid back with regular instalments over period of time
  - ✓ Usually linked to life time of asset
  - ✓ Maintenance and insurance responsibility of lessee
- Leaseback financing
  - ✓ Assets of more permanent nature
  - ✓ Assets that a business own is sold to credit supplier and then leased back by business according to a long term agreement
  - ✓ Usually entered into by a business that need to raise funds
  - ✓ Business obtains cash without losing the use of property or equipment
  - ✓ Lease payments are deductible from tax

Sources of financing for small businesses

- Personal funds
- Loans from relatives and friends
- Trade credit
- Loans or credit from equipment seller
- Commercial bank loans
- Small business loans
- Taking in partners
- Selling capital shares
- Venture capital funding

Cost of capital

- In capital investment decisions cost of capital serves as benchmark for investment proposals
- In financing decisions various types of capital earmarked for financing the investments of business should be combined so that cost to capital to business is kept to minimum
- Capital structure refers to combination of forms of long term financing and preference shares and debt to finance of a business

Risk

2 components:

- ✓ Possible loss of principle sum
- ✓ Possibility that no compensation will be paid for the use of capital (no interest dividend payments)

MARKETING

Evolution of marketing thought

Operation oriented management

- Operation oriented organization tried to increase the number and variety of products they produced.

- Products:
  - ✓ What can we do best?
  - ✓ What can our engineers design?
  - ✓ What is easy to produce?
- Services:
  - ✓ What services are most convenient to us to offer?
  - ✓ Where do our talents lie?
- Disadvantage was management concentrated in encouraging production in order to solve operation problems

Sales operated management

- Stocks began to pile up
- Management became more sales oriented
- Misleading advertisements were offered
- Objective to sell products at all cost
- Led to excessive promotion, high advertising and sales cost
- Increasing competition – higher marketing management

Marketing oriented management

- Not just sales and price to be considered but also:
  - ✓ Quality of products
  - ✓ Packaging
  - ✓ Choice of distribution channels
  - ✓ Method of informing potential customers

Consumer oriented management

- Increasing consumer products available and financial position of consumers improved- consumer demands changed
- Consumer needs, demands and preferences need to be considered
- These decisions include:
  - ✓ Choice about quality
  - ✓ Packaging of products
  - ✓ Brand name
  - ✓ Type of distribution channel
  - ✓ Price
  - ✓ Marketing communication methods

Strategic approach to marketing

- Continual change in marketing environment and need for survival and growth means management needed to concentrate on long term environment scanning
- Scanning allowed management to identify:
  - ✓ Environment changes – technological innovation
  - ✓ Economic influences
  - ✓ Political factors
  - ✓ Changing consumer preferences
  - ✓ Demographic aspects
  - ✓ Increasing competition
- Maintaining close relationships internally and externally is important

Relationship marketing

- Needed to establish long term relationships with people and institutions in environment
- Long term relationship with customers – loyalty and repeated purchase of need satisfying products
- Long term relationships with supplies ensure availability of raw materials and inventory
- Primary objective is to establish and maintain relationships with loyal profitable clients
- To obtain this:
  - ✓ Attraction
  - ✓ Retention
  - ✓ Enhancement of customer relationships
- loyal customers important
- Loyal customers basis of organization operations
- Buyers and sellers should strive towards same objectives
- Long term relationship between producers and intermediaries can ensure products availability at right time and right place
- Everyone needs to realize customer satisfaction and marketing success will be needed in own career opportunities and remuneration
- Marketing task in market driven organization - need to be done according to ethical code
- If you promise something and don't deliver = fraud

Marketing concept

- Is the ethical code according to which marketing task is performed
- It directs all marketing decisions about:
  - ✓ Products
  - ✓ Distribution methods
  - ✓ Marketing communication
  - ✓ Price determination
- 4 principles of marketing concept:
  - ✓ Profitability
  - ✓ Consumer orientation
  - ✓ Social responsibility
  - ✓ Organizational integration

Profitability

- Is the long term maximization of profitability
- Primary objective in free market
- Main objective in free market
- Fundamental to marketing concept
- Emphasis profitability not sales

Consumer orientation

- Satisfaction of consumer needs, demands and preferences constitutes a consumer oriented approach.
- Even though consumer is very important satisfaction of consumer needs can never be achieved
- Satisfaction can only be given within constraints of profit objective and resources of business
- Consumer oriented means consumer must be supplied with adequate and correct info

Social responsibility

- Business often discharge this responsibility by spending money on projects like housing, education
- This created a stable environment for future profits
- Enhances corporate image with employees, consumers, public
- Should a business act irresponsibly = punitive measures
- Sponsorship must be supported by marketing communication to ensure large audience
- If successful – new coverage
- Marketing management must ensure that nothing detrimental is done

Organizational integration

- Express need for close co-operation between all functions of business
- All functional decisions – successful marketing
- Co-operation between:
  - ✓ Marketing
  - ✓ Operational
  - ✓ Purchasing
  - ✓ Other function
- Organization integration pre-requisite for success.

Merits of marketing concept

- Criticism of consumer exploration is refuted by principles of marketing concept
- Marketer guards name of product
- Pay attention to criticism

Defining marketing

- Consists of management tasks and decisions
- Directed at meeting opportunities and threats
- In dynamic environment
- By effectively developing and transferring a need satisfying market offering
- To consumers
- In such a way that the objective of business and consumer and society will be achieved

Components of marketing process

- Simplest form of marketing process is transfer of products / services from one person to another
- In business management marketing entails transfer of a product to a consumer
- Fundamental of marketing process is a need and transaction to satisfy that need
- Marketing – transaction between 2 parties (organization and customer)
- 4 variables are used to make decisions: (4 P's)
  - ✓ Product itself
  - ✓ Place where it is offered (distribution)
  - ✓ Marketing communication methods to inform customer (promotion)
  - ✓ Price – reflects the products value
- 4 variables = marketing mix that combine to form market offering the consumers purchase
- Marketing offering should not satisfy individual but market segment
- From diff market segments target market is selected

- Market research done for info on:
  - ✓ Market
  - ✓ Competitors
  - ✓ Environmental changes

Market research

Need for information

- To manage information is needed
- Continuous scanning micro, market and macro environment
- Do SWOT analysis before decisions are made
- Info collected via scanning should include:
  - ✓ External variables and internal resources in form of records and reports about current prices
  - ✓ Sales figures and market trends
  - ✓ Changes in market share
  - ✓ Consumer preferences
  - ✓ New legislation
  - ✓ Product schedules
  - ✓ Internal financial problems
- Information can also be obtained from market research
- This information needs to:
  - ✓ Increase understanding of relevant market segment and it's consumers
  - ✓ Be pertinent to planning and controlling
  - ✓ Help decisions making once alternative sources of info is considered.

Marketing research methodology

- Systematic gathering analysis and interpretation of info about all types of marketing problems
- Use recognized scientific methods for accumulation of into to facilitate market management decision making
- Recognized method = survey method
- Use a questionnaire
- Trained field workers to ask questions
- 12 steps to conduct survey:
  - ✓ Description of problem to be investigated
  - ✓ Formulation of probable explanations and causes for define problem
  - ✓ Investigate all hypothesis to dominate less likely and to find solution to problem
  - ✓ Compilation of questionnaire:
    - Specify info needed
    - Specify type of interviewing method
    - Determine content of individual questions
    - Design questions to overcome respondents inability and unwillingness to answer
    - Decide on structure of questions
    - Arrange questions in order
    - Identify form and layout
    - Reproduce questionnaire
    - Pre-test questionnaire
  - ✓ Testing of questionnaire
  - ✓ Selections of respondents

- ✓ Training of field workers
- ✓ Analysis and assimilations of info collected
- ✓ Interpretation of information
- ✓ Writing of research report and making recommendations based on conclusions
- ✓ Manage evaluation
- ✓ Implementation of management decisions

Market forecasting

- Before exploiting opportunity potential in terms of profit must be established
- Measuring size of opportunity is forecasting future sales

Sales forecasting

- Following types often used:
  - ✓ Forecasting done by panel of experts from in and out of organization
  - ✓ Forecasting based on market research
  - ✓ Forecasting based on consumer reactions in test marketing
  - ✓ Forecasting based on historical data
  - ✓ Forecasting based on mathematical and statistical models

Forecasting on profit contribution

- Done for long term periods
- Done for full payback period = time taken to recoup capital expenses incurred of producing a product
- During payback the money invested has to be recovered through earnings generated by sales

Consumer behaviour

- Behaviour patterns of decision making units (individual / family) directly involved in purchase and use of products
- Including decision making process preceding and determining the behaviour patterns
- Consumer behaviour consist of overt acts (observable)
- Also include covert process (not observable)
- Cannot see the weighing up financial position
- Knowledge of factors that determine consumer behaviour from basis of consumer oriented marketing strategies
- Consumer receives inputs from environment
- Output is what happens
- In between are constructs – process to decide to buy
- Individual / group factors influence decision making

Determinants of consumer behaviour

- 2 main factors:
  - ✓ Individual factors peculiar to person
  - ✓ Group factors

- Decision making by buy in centre:
  - ✓ Consideration of different roles of members of buying centre
  - ✓ Differing interpretations of objectives
  - ✓ Interpersonal influences
  - ✓ Relative power and need for resolution of possible conflicts among members of buying group.

Individual factors

- Needs – motives
- Attitudes
- Learning ability – learn marketers message
- Personal traits
- Consumer perceptions

Group factors

- Family
- Reference groups
- Opinion leaders
- Culture group

Consumer decision making

- Every decision involves risk
- Functional risk – product does not work
- Social risk – peer group do not approved of purchase
- During time a consumer takes to make decision marketers try to influence them
- 4 influences in Organizational buying decision:
  - ✓ Environment
  - ✓ Organization itself
  - ✓ Buying group
  - ✓ Individual buyer
- Decision making process has phases:
  - ✓ Awareness of unsatisfied need or problem
  - ✓ Gathering of info on how to best solve problem
  - ✓ Evaluation of possible solutions
  - ✓ Decision on course of action or purchase
  - ✓ Post purchase evaluation
- Habitual purchasing when clients are loyal

Market segmentation

- Market consist of people with diff needs and wants
- Marketer must decide what to fulfil
- Must focus on group in market
- Market = consists of relatively large no of people who:
  - ✓ Have a need for a specific product
  - ✓ Have the money to buy it
  - ✓ Are willing to spend money on it
  - ✓ Are legally able to buy the products
- For market to exist all of above must be in place

- Market can be subdivided:
  - ✓ Consumer market
    - Individual purchasing for own consumption
  - ✓ Industrial market
    - Groups purchasing raw material to produce goods
  - ✓ Resale market
    - Individual, groups, org's purchasing products to resell
  - ✓ Government market
    - State department purchasing products need to supply services
- Effective market segmentation should follow steps:
  - ✓ Identify the needs of consumers in the market
  - ✓ Group needs in homogenous subgroups with similar characteristics
  - ✓ Select target markets on which organization will focus
  - ✓ Position products within selected segment

Total market approach – market aggregation

- Target all customers in same way
- E.g. salt, flour, bread
- Market aggregation is exception not rule
- Because customers' needs are different

Market segmentation approach

- Total heterogeneous market subdivided in homogenous groups with uniform characteristic
- Diff products are developed to satisfy different needs
- Multi segment approach in which many segments are served with basis product with minor changes
- Or choose one segment and focus on them
- 3 approaches:
  - ✓ Total market approach
  - ✓ Single segment approach
  - ✓ Multi segment approach

Requirements for meaningful market segmentation

- Segment must be identifiable and measureable
- Must be substantial and sustainable
- Must be reachable
- Must be responsive

Criteria for market segmentation

- Geographic area – place of residence
- Demographic – age, gender, family size
- Psychographic – personality factors, lifestyle
- Behavioural criteria – purchase occasion, benefits sought, user status, usage rate.
- Brand loyalty is encouraged when customers become loyal – competitive position is strengthened
- Price sensitivity – consumers want cheaper prices
- Reverse price sensitivity – consumers act negatively if price is too cheap

- Consumers are sensitive to:
  - ✓ Service
  - ✓ Quality
  - ✓ Advertisements
- Market can also be segmented by product benefits
- Segment profile = when criteria combine benefits and products

Segment profiles

- Demographic, geographic and usage provide a profile for specific segment

Target market selection and positioning

- Heterogeneous groups subdivided into homogeneous groups
- Objective and resources of organization must be considered before a target market can be selected
- Target market selection is not only 1 market
- Selection does not mean you own selected market
- Decide on direct marketing or niche marketing

Marketing instruments

- 4 marketing mix instruments
  - ✓ Product
  - ✓ Distribution
  - ✓ Marketing communication
  - ✓ Price

Product decisions

Product offering

- Products offering can be single item of number of items
- Changes according to demands at time on situation in market
- Product decisions – decisions of product itself like brand, packaging

What is a product?

- Composition of tangible or intangible need satisfying utility offered to customers by an organizationso that customers can take note of them, procure them and use them.
- Consumer products consist of:
- Total product – all above mentioned components

Classification of consumer products

- Consumer products are intended for immediate use by households
- Durable – fridge, cars
- Non-durable – milk, chocolate
- Can be classified on basis of consumer buying habits:
  - ✓ Convenience products – sweets
  - ✓ Shopping products – clothing
  - ✓ Speciality products – unique characteristics

Brand decisions

Meaning of brands

- Mark that is unique to a product marketed by business
- Is chosen to distinguish them from other competitors
- Includes brand name, specially designed trademark
- Brand name is a word
- Trademarks act – can use them for 10 years

Advantages to use brand names – consumer

- Facilitate identification of products when purchasing
- Assume consumer of quality standard they can count on
- Offer a certain degree of protection to consumer
- Facilitate decision making
- Serve as a warning against products that don't meet the requirements set by customers

Advantages to use brand names – marketer

- Brands are foundation stone of marketing communication strategy
- Brands promote brand loyalty among consumers
- Make price comparison with competing products more difficult
- Brands are inseparable part of product image
- Brands make products differentiation possible
- Brands facilitate expansion of existing products

Brand loyalty

- Is a result of good product quality, proven usefulness and repeated marketing communication
- 3 phases of loyalty:
  - ✓ Brand recognition
  - ✓ Brand preference
  - ✓ Brand insistence

Manufacturer, dealer or generic brands

- Large retailers by unmarked products and use their own names
- Manufacturer must decide to offer unmarked products
- There must be a market for unmarked products

Individual / family brands

- Marketing management must decide to use individual brand eg black label or use family brands e.g. Kellogs
- Family brand – cost of introduction to market is cheaper
- New products – benefits of the popularity of other products
- Individual brands are expensive to market
- Separate marketing communication for every product

Packaging decisions

- Group of activities concerned with design manufacturing and filling a container or wrapper
- With product item so that it can effectively protected, stored, transported, identified and successfully marketed.
- Should be designed so that product can be handled without damaging content
- Should promote product sales
- Use bright eye catching colours

Different kinds of packaging

Family packaging

- All products in range are more or less packed identically
- Related to family brands

Speciality packaging

- Gives image of exclusivity to product
- Perfume and jewellery

Reusable packaging

- Image of free container
- Leads to repeat purchases because consumers collect tins

Choice of package design

- Marketers often choose different and better packaging that competitor
- Shapes of packaging – symbolic value
- Males – square
- Females – round
- Unusual sizes draw attention but price comparison is made difficult

Product differentiation

- Differentiation by means of packaging and brand
- Differentiation by advertisement appeals
- Diff on basis of price
- Diff on basis of distribution outlet

Product obsolescence

- Product can be made obsolete technically and physiologically to compel consumer to repeat purchase
- Technical – light bulb
- Physiological – new fashion or style
- Physiological – old product might be effective but is discarded to buy new product
- Planned obsolescence often criticized – waste of scarce resources
- Contributes to economic progress and job creation

Multiproduct decisions

- Business seldom market one product
- Usually range of products
- Total product offering change continuously
- Multiproduct items in total product offering reduces risk of failure
- One product performs poorly – other products can make up for it.

New product decisions

- Somewhere someone comes up with idea to satisfy a consumer need
- Some places have teams
- Workers encouraged to have new ideas
- Could be new – innovation
- Could be improvement on current product
- Risk of failure greater to market with innovation
- Possibility for higher profits also exists
- Phases of new products development:
  - ✓ Product ideas are developed
  - ✓ Ideas are screened according to fin criteria
  - ✓ Idea not viable, discarded
  - ✓ Physical product development done + prototype developed
  - ✓ Marketing strategy development:
    - Positioning of product in market
    - Choice of brand
    - Design of packaging
    - Compilation of marketing communication
    - Decision of price
    - Choice of distribution outlet
  - ✓ Test marketing in small market segment
  - ✓ Product introduced to market

Nature of products life cycle

4 phases:

- ✓ Introductory
- ✓ Growth
- ✓ Maturing
- ✓ Declining

Marketing strategy during products life cycle

Integrated market strategy

Introductory phase

- Objective – to create demand
- Target market – those who are prepared to risk buying new products
- Product decisions – taken during products development
- Distribution decisions – involve selective market coverage
- Price decisions – high initial price is fixed
- Marketing communication decisions – sale promotion techniques are used

Growth phase

- Objective – to develop demand
- Target market – consumer who is less receptive to new products
- Product decisions – minor product modifications are made
- Distribution decisions – involves more selected market
- Price decisions – declines due to competition
- Marketing communication decisions – advertising via mass media

Maturity phase

- Objective – counteract competition
- Target market – new markets are sought
- Product decisions – modifications have to be introduced
- Distribution decisions – intensive market coverage
- Price decisions – current market prices should be adhered to
- Marketing communication decisions – persuasive marketing via mass media

Declining phase

- Objective – maintain market share or withdraw product
- Target market – older more conservative group
- Product decisions – no modification considered
- Distribution decisions – limited market coverage
- Price decisions – prices reduced, products on sale
- Marketing communication decisions – personal selling only where products are still in demand

Price decisions

Meaning of a price

- Exchange value of products / services
- Closely linked to concepts as benefit or value
- Value determined by its benefit to the consumer and sacrifice needed ito money and effort to obtain products
- Marketer and consumer attach diff meanings to price concept
- Marketing = price is marketing instrument to achieve business objective
- Consumer = price is sacrifice of disposable income
- Often not possible to specify single price due to:
  - ✓ Large no of products
  - ✓ Geographical distribution of consumer
  - ✓ Segmentation of market
- Price is one of 4 marketing instruments, if any instrument changes price will also change

Price determination process

4 phases – the determination of:

- ✓ Cost price
- ✓ Market price
- ✓ Target price
- ✓ Final price

Cost price

- Responsibility of cost and accounting department
- Unit costs are calculated
- Product price cannot be lower than cost

Market price

- Is the price the consumer is prepared to pay
- Marketing management responsibility
- Use marketing research project
- Survey on competitors' prices
- If cost price is much higher than market price – cost reduction adjustment must be made

Target price

- Price that will realize the target rate to return
- Taking into consideration:
  - ✓ Cost structure
  - ✓ Business capital needs
  - ✓ Potential sales volume of product
- Calculation = cost plus method
- Adding profit margin to unit cost

Final price

- Price at which products is offered to consumer
- Reconciliation of market price and target price
- Somewhere between market price and target price

Adaptions to final prices

- Skimming process
- Market penetration prices
- Market price level
- Leader prices
- Odd prices
- Bait prices

Skimming process

- If product is innovation final prices may have a much higher profit margin
- Consumer prepared to pay because it has a prestige value
- Reason for innovation price to be high – development costs has to be recovered
- As product gains popularity price can be dropped

Market penetration price

- Initial phase is lower
- Marketer hopes to penetrate market rapidly
- Discouraging competitors prices in process

Market price level

- Where there is keen competition and numerous similar products
- If price is higher than competitors – consumer avoid products
- If price is lower than competitors – consumer thinks something is wrong with product
- Products must be successfully differentiated and regarded as unique

Leader prices

- Special offers
- Used to lure consumer to their shops
- Consumer buy specials and other higher priced products
- Small profit made on leader prices
- Sold for limited time only
- If manufacturers are not prepared to give products as special offers retailers can refuse shelve space

Odd prices

- Consumers accept odd prices
- Even prices are avoided

Bait prices

- Unethical
- Avoided by retailers
- Has a low price and is advertised widely
- When customers come to buy, they buy much more expensive products

Distribution decisions

Description of distribution

- Transfer take place along specific distribution channels
- Which consist of intermediaries (wholesalers and retailers)
- Marketing management task is to link manufacturer and intermediaries to make products available at high price at right time
- Must be decisions about distributing channel
- Includes logistical activities – physical distribution

Choice of distribution channel

- Manufacturer – consumer (direct distribution e.g. vegetables and milk stall)
- Manufacturer – retailer – consumer (indirect distribution e.g. products are transported)
- Manufacturer – wholesaler – consumer
- Manufacturer – wholesaler – retailer – consumer
- Manufacturer – wholesaler – wholesaler – retailer – consumer

Channel leadership

- Marketing makes decision for distribution channel
- Business that control the decision = channel captain

Manufacturers as channel captain

- If manufacturer is channel captain intermediaries will have to be persuaded to distribute products
- They may persuade intermediary to create a demand for products by intensive marketing communication at consumer
- Known as the "pull" – products is pulled through channel by means of consumer demand
- Intermediaries may also be persuaded to "push" product by actively encouraging sales of products in store
- Shop competitions – supplied by channel captain to encourage sales
- Difficult to find self-space for new products
- Demand must be created by advertising

Retailer as channel captain

- If retailer has:
  - ✓ Network of branches
  - ✓ Enjoys store loyalty
  - ✓ Has adequate financial resources
- It can take over channel leadership and lay down commands to the producer eg Pick and Pay
- Leader can push / pull product
- Retailer advertises and produces products – special offerings
- Manufacturer would rather maintain leadership themselves
- If manufacturer succeeds in obtaining brand loyalty consumer will avoid shops that do not stock those products
- Different types of retailers in South Africa:
  - ✓ General dealers – offer wide range of products and operate in retail areas
  - ✓ Department stores – large stores and sell products in departments – children's clothing
  - ✓ Specialty stores – narrow but deep range of products – jewellery
  - ✓ Chain stores – similar shops all over the country – Woollies
  - ✓ Supermarkets – operate on self-service basis e.g. groceries – Shoprite
  - ✓ Convenience stores – bread and milk – garage shops
  - ✓ Discount stores – high stock turnover and low prices – Game
  - ✓ Hypermarkets – larger than supermarkets and in addition to groceries also sell semi-durable products e.g. fridges
  - ✓ Shopping centres – large buildings that house independent retailers
  - ✓ Mail order stores
  - ✓ Internet stores
  - ✓ Informal retailers – Spaza shops in rural areas

Market coverage

No of intermediaries in channel directly linked to type of market coverage aimed at
Types:

- Inclusive / Intensive:
  - ✓ As many suitable and available intermediaries as used e.g. Coke sold everywhere
- Exclusive
  - ✓ Manufacturer purposely limits number of people handling it's product

- ✓ Only a few intermediaries get exclusive rights to sell products
- Selected market coverage
  - ✓ Selection of any of those intermediaries that will distribute product efficiently
  - ✓ Between intensive and exclusive marketing areas e.g. chemists

Physical distribution

- Transportation
- Inventory holding
- Receipt and dispatch
- Packaging
- Administration
- Ordering
- Purpose is to maintain a satisfactory level of service to clients at lowest possible distribution costs
- Effective performance on physical distribution side can mean huge savings and have product atright place at right time
- 3 main components:
  - ✓ Selecting a warehouse
  - ✓ Selecting most suitable way of transport
  - ✓ Selecting optimal inventory levels
- Most effective performance of physical distribution ensures:
  - ✓ Timeous and reliable delivery of orders
  - ✓ Adequate inventory so that shortages don't occur
  - ✓ Careful handling of stock to prevent damage

Marketing communication decisions

Nature of marketing communication

- Consumer is removed from manufacturer in time and space
- Marketing management to communicate with consumer products available
- Consumer should be persuaded to repetitive purchasing
- Marketing communication = process of informing, processing and reminding the consumer
- 6 elements:
  - ✓ Advertising
  - ✓ Personal selling
  - ✓ Direct marketing
  - ✓ Sales promotion
  - ✓ Publicity
  - ✓ Public relations

Advertising

- Controlled and paid-for-non personal marketing communication
- Related to need satisfying products
- Directed by marketer at specific target audience

Advertising media

- Television, movies and radio
- Placement of single advertisement – expensive

- Care taken about marketing message and choice of media
- Marketers should be sure that target audience will be reached
- Billboard used when people are busy with other activities – people who do not read
- Market research done to ensure right media is used

Advertising message

- Formulation of message – careful attention
- Printed media:
  - ✓ Heading:
    - Attracts consumer attention
    - Deliver main appeal
    - Printed in bold letters
  - ✓ Illustration
    - Photo or drawing
    - Colour of black and white
    - Stimulates reader to read copy which contains products information
    - Product itself including packaging and label should also appear in illustration
    - Intended target audience must relate to model used in illustration
    - Radio – jingles are used
  - ✓ Copy

Personal selling

- Verbal presentation of a product service or idea
- To one or more purchasers to conclude a transaction
- Sales representatives used
- Wholesales sales reps can to retailers to sell products
- Personal selling – door-to-door – Tupperware
- Sales by shop assistants over counters

Direct marketing

- Used advertising media to communicate info about products to consumer
- Consumer can buy products from the comfort of their own home
- Principle of economy – spending more time at home
- Has the following benefits:
  - ✓ Long term relationship can be developed with consumer
  - ✓ Message can be directed at specific consumer
  - ✓ Consumer database can be developed
  - ✓ Results of direct marketing campaign can be measured directly
- Telemarketing – telephone calls
- Catalogues – Verimark and Glomail

Sales promotion

- Marketing communication that are not:
  - ✓ Advertising
  - ✓ Personal selling
  - ✓ Direct marketing
  - ✓ Publicity
- E.g. diaries, calendars, t-shirts

- Short term objectives e.g. to introduce new products to market

Publicity

- Non-personal stimulation of demand for a product by making it's actual current news valueavailable to mass media
- To obtain favourable and free media review of business and products
- Message to be conveyed must make news value
- Business often sponsor large event and by doing so gain publicity
- Can be expensive
- Marketing management to decide which sponsorship are of value

Public relations

Defining public relations

- Deliberate activity
- Planned activity
- Sustained activity
- Communication process
- Deals with public both internal and external
- Decision making to help organization ability to listen to appreciate
- and respond to those who mutually benefit relationships
- organization need to foster as if it strives to achieve vision and mission
- Deliberate activity:
  - ✓ Conscious, purposeful activity of business management
- Planned activity:
  - ✓ Operation that anticipates events
  - ✓ Prepared for problems and contingencies
  - ✓ Geared towards future
  - ✓ Should be ready for problems
- Sustained activity:
  - ✓ Account of fact that public is in constant process of change
  - ✓ Consumer forget business easily
  - ✓ Must constantly be reminded
- Communication process
  - ✓ Public relations pre-supposes communication between individual and business
  - ✓ Task of public relations to establish channels through mass media
  - ✓ Appoint communication experts that know about functionality of products
  - ✓ Public relations should be part of top management
- Deals with public internal and external
  - ✓ Public is any group that influences organization or it operations
  - ✓ Internal – employees and management
  - ✓ External – outside organization , unions, media, community, government
- Public relations entail creating and maintaining good will towards a business
- Important to maintain goodwill once it has been obtained

Public relations media

Communication media is channels used to convey communication message:

- Spoken word
  - ✓ Face to face
  - ✓ Most important method of communication
  - ✓ Communicator and listener speak the same “language”
- Printed word
  - ✓ Newspapers, magazines, company publications
  - ✓ Carefully selected pictures are used to reinforce message
- Sight, sounds and symbols
  - ✓ Radio, TV, films and videos
- Electronic word
- Images on internet
  - ✓ Increasing consumer demand to be educated as opposed to merely being soldproducts
  - ✓ Time is of essence
  - ✓ Increasing need for customization
- Special events
  - ✓ Press conferences
  - ✓ Visits to business
  - ✓ Receptions
  - ✓ Exhibitions
  - ✓ Crises management