**chapter i4 Managing working capital**

Cash flow and working capital

**Fixing the heating**

Pete Wilson is a gasman or more correctly he was a gasman, a self-employed heating engineer. Having been made redundant by one of the large suppliers Pete spent half his redundancy money on a new van and half on a training course to upgrade his skills.

Pete started up as a sole trader and with contacts already established in the area, and with the gift of the gab, he soon found customers. He was good at his job and orders poured in. Pete found himself working a 7-day week, 12 hours a day. He was prepared to do this for a period of time to get his business a good reputation.

With a full order book Pete was feeling good. He got his girlfriend to invoice clients with a 30 day credit period. Unfortunately she did not have the time to do this immediately so sometimes customers were getting up to two months credit.

In the meantime, Pete, because he had no trading track record, had to pay up front for his materials. His cash flow situation became desperate but he managed to secure overdraft facilities on the basis that he had plenty of orders. Money came in slowly, a couple of customers never paid him at all, and he soon reached the upper end of his overdraft limit. He had no cash to pay suppliers, neither could he repay his borrowings and he went bust. Pete's experience is a cautionary tale to all those seeking to open their own business.

**Questions**

1. Why were Pete's suppliers unwilling to give him credit?
2. What would be the implications for the bank if it had increased Pete's overdraft?
3. Being a sole trader means being the only owner of a business but it doesn't necessarily mean being the only worker in a business. Should Pete have employed someone to run the clerical side of the business? Explain your answer.

Working capital is the money a business needs to pay its short term expenses. These include:

* expenditure like Pete's training
* any raw materials or stocks of inputs
* bills, e.g. for electricity or petrol
* wages, e.g. enough for Pete to live on.

All businesses need working capital. You can see how much working capital a business has by looking at the balance sheet. Working capital is more or less covered by three items, stock (i.e. stocks of inputs or output), debtors (i.e. money owed to the business) and cash in the bank. (There is an example on page 74.)

Working capital is the money needed to keep going in the time gap between paying out cash for all the input costs incurred during production and the time when sales revenue comes in from the customers.

Balance sheet: a statement of the firm's assets and liabilities. Assets add to the value of the business. Liabilities are loans that may have to be repaid.

How much working capital is needed?

The amount of working capital held by a business will vary depending on:

Negative cash flow

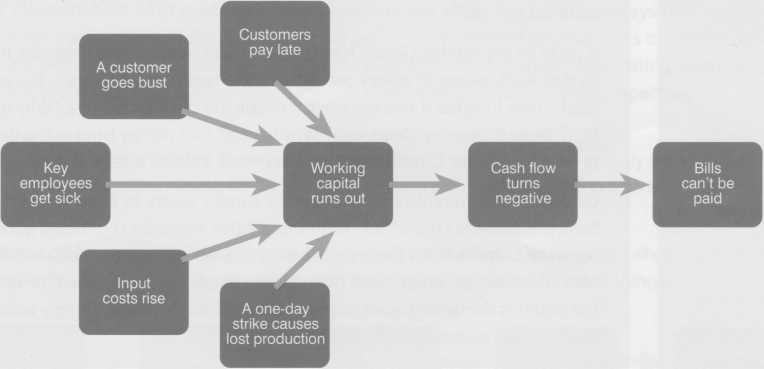
* the type of business
* the credit terms a business may be able to negotiate from suppliers
* the credit it extends to customers.

A new business like Pete's may not be able to negotiate any credit period; cash on delivery may be demanded. This may mean that it is not possible to extend credit to customers. However, customers that have some market power (e.g. supermarkets or other businesses) may be able to insist on payment 30 or 60 days after invoicing. It may be necessary to raise working capital to provide this credit.

In general, manufacturing businesses need much more working capital than businesses in the service sector. Dyson has to pay for product development, which is very costly, long before production starts and sales revenue comes in. An antique shop or an advertising agency can rent premises and be selling to customers within a few weeks.

A business with too little working capital may end up with a negative cash flow. But holding too much working capital may be costly and wasteful. Monitoring the use of working capital may save money.

Figure 13: Too little working capital



Working capital in the accounts

In accounting terms, working capital can be calculated by deducting current liabilities from current assets. Current assets consist mainly of stock, debtors (money that will be paid in) and cash held at the bank. Current liabilities are mainly creditors (money that is owed). The concept 'current' refers to a short period of time, usually a year. An asset is something a business owns and a liability is something a business owes.

An accountant might suggest that the ratio of current assets to current liabilities should be 2:1, i.e. that firms should hold twice the value of current assets to current liabilities. Given that a good deal of the value of current assets used to be tied up in stocks, and that generally firms hold fewer stocks now due to the adoption of JIT stock management, the ratio is usually much lower. Firms should still aim to have sufficient working capital to pay for their short term debts.

Current liabilities are short-term loans that must be paid within a year or less. They include overdrafts and any trade credit offered by suppliers.

Current assets include stocks of inputs or output, debts to the company that will bring in cash in the future, and cash at the bank.

How problems develop

**Question**

Which of the two garden centres has the best working capital position?

Before answering the question consider the following points:

Both businesses have positive working capital, i.e. they are able to pay off their short term debts quite easily.

It could be argued that Garden Needs is in a better position, and it may be. It appears to have a good level of stock, plenty of money owing to it and a healthy bank balance. But why is it carrying so much stock? How long has it had the stock for? Will the stock deteriorate? Why has it got so much owing to it? Does it chase up debts well? Why have all that money lying in the bank? Can it not be made to work? And why, considering the points made already, does it still owe £10,000?

Garden Needs' current ratio (the ratio of current assets to current liabilities) is 4:1, compared to Sunshine Gardens ratio of 3:1. Both these ratios would be considered good but perhaps too high. Sunshine Gardens holds lower stock levels, is owed less money and carries less 'spare' money in the bank. Its creditors, whilst lower than Garden Needs, are higher than the amount in the bank and if the creditors demanded quick payment it would not be able to comply without realising some of its other current assets. Consider your verdict.

Recession



**Carden centres**

Compare the following components of working capital for two garden centres.

Garden Needs

Sunshine Gardens

Stock

Debtors

Bank

£20000

10000

10000

Stock

Debtors

Bank

£10000

4000

4000

40000

18000

Current Liabilities Creditors

10000

Current Liabilities Creditors

6000

£30000

£12000

Businesses that use detailed budgets will examine variances carefully and will get an idea of how well they are doing. What that doesn't show is how quickly cash is coming into a business and how quickly it is going out. Only when actual cash flows are compared with forecasted cash flows will it become clear if a firm is cash rich or cash poor. Firms with a good system of variance analysis and cash flow management will be able to react quickly to cash flow shortages.

When the economy is doing well businesses do not necessarily need to be as cash rich as they do when the economy is not doing well. Some businesses perform well in hard times; discount stores and supermarkets that concentrate on non-branded products are two examples. But most businesses find that they have fewer customers and they are spending less. Having cash available in times of hardship is a godsend for businesses. In 2008, many businesses fortunately had savings from the good years. If they had not, the recession would have been much worse.

When the market is growing, many businesses will want to expand to take advantage of the demand for their products. But long before they can sell the final product, they have to have funds to cover their costs of production. If they expand faster than they can pay their bills, they are said to be overtrading. This was probably what happened to Pete in the opening case study. Business owners need to know, either from past

experience or from the signals in their monthly cash flow, when they will need to inject extra finance into their business.

Overtrading

Overtrading occurs when a business, especially a new business, rapidly expands, taking in orders that cannot be supported by its working capital. This can have serious repercussions.

Contingency finance planning

Contingency finance planning should be in place before any crises are identified. There are several possibilities and the first port of call may not be the bank. Other measures include:

* managing supplier credit
* managing customer credit
* can stocks be reduced?
* factoring.

Banks are out to make profits for their shareholders and much of that profit comes from business customers. Rather than rushing to the bank, businesses should make sure they have reviewed their internal procedures first.

Good relationships with customers and suppliers are vital. If a business always pays suppliers on time, doesn't always wait 30 days or more before paying, it can expect those suppliers to reciprocate when times are hard. After all, suppliers need customer businesses to stay afloat. Negotiating extended credit terms would be worthwhile but businesses that have not been good payers cannot expect favours. Supplies may be cut off.

Customer

relationships

Can customers be persuaded to pay up more quickly? Even if only a few comply with this request, a cash crisis may be averted. Giving better discounts to those who do pay quickly can give them an incentive to pay quickly.

If stocks can be reduced, less working capital will be needed. The flow chart shows how JIT stock control might allow destocking, save money and free up working capital for other things.



There is no one magic figure for the right level of working capital. Having more might make it possible to run the business more efficiently or buy inputs in bulk, so that prices can be cut and sales increase. Or it might be possible to buy from a cheaper supplier that does not offer credit terms. Being able to offer extended credit to customers might help to keep customers who would otherwise go elsewhere.

Managing working capital is vital to the business. But having more is not necessarily the answer to a cash flow problem. It might be better to use existing working capital more effectively - by any method mentioned above.

Factoring

If a business has had some difficulty collecting debts, or cannot find the time to chase them up, factoring may provide an answer. Factors specialise in taking over debts from businesses in this position. The business 'sells' the debt to the factor, who will collect it later. The business gets a payment that is less than the amount of the bill. If the debtor is generally a regular payer, the factor may pay an amount close to the value of the debt. If the debt is more toxic, the amount received will be lower.

An overdraft or a loan?

Many businesses seek overdraft facilities from their bank to help tide them over in the initial months of slow growth. Other businesses, especially if they face seasonal sales fluctuation, may need overdraft facilities when trade is slow. A condition of receiving overdraft facilities, i.e. the ability to make payments over and above the amounts available in the business bank account, often states that the business owner must inject some capital of their own into the business bank account.

Borrowing

Factoring means passing the debt to someone else in return for a proportion of its value. The factor (which may be a department of the bank) will assume responsibility for collecting the debt. It will pay the business the amount of the debt, less a discount that reflects the risk they are taking on and the length of time before payment.

An overdraft is an agreement between bank and client that allows the clients to make payments up to an agreed limit, over and above what is in that account. Banks will give new customers free banking for a period of time, usually a year, but then they will start to make money. Usually there is the monthly service charge. As soon as the business draws on its overdraft facility, interest charges will be incurred. It is true that they are only raised for the period of time that the account is overdrawn but in times of recession that may be a long time for many firms.

Overdraft: a loan facility offered by banks whereby businesses (and individuals) can make payments, up to a certain limit, even when there is no cash in the account.

The rate of interest on an overdraft is usually higher than that on a loan and woe betide any business that exceeds its overdraft limit. Further interest will be charged and that may include interest on the interest, as well as a charge for exceeding the limit. If cheques bounce there will be more charges.

This is a very gloomy scenario, a kind of self-fulfilling prophecy. Overdrafts that are managed well are very useful for businesses, getting them out of short-term cash flow problems, but they certainly should not be used to cure long-term structural problems, such as replacing unprofitable facilities.

Loans

Loans involve borrowing a fixed sum of money, repayable in fixed amounts, each repayment bearing a proportion of the interest charge, over a fixed period of time, two years or five years for instance. In this they are similar to mortgages. They provide a degree of certainty for the borrower, as they know when and how much they will be paying out each month. The interest rate is generally lower than that on an overdraft although interest is paid on the full amount for the period of the loan, even though the full amount is not owed for that full period. If the loan brings rewards in terms of extra income and profit, it can be paid off early, thus removing some of the interest burden.

Business loans are generally provided for specific purposes such as the purchase of a machine, or vehicle, or other fixed asset. They help manage working capital in that they should bring long term rewards to a business, thus enhancing the chances of positive cash flow. A new machine may lead to faster production processes at a lower cost per unit, so saving the firm money and bringing in extra revenue. Loans may help with contingency finance planning if they lead fairly quickly to an improved cash flow position. An investment that successfully delivers extra sales revenue and profit will increase working capital.

Show what you know

1. Explain, in your own words, the difference between a loan and an overdraft.
2. Draw up a table showing the advantages and disadvantages of loans and overdrafts.
3. Some events cannot be predicted with any certainty. Therefore contingency finance planning may be needed. In what circumstances might an overdraft or a delay in paying a supplier be seen as an example of contingency finance planning?
4. Why is it important for firms to monitor their working capital?
5. What dangers might face firms that rely too heavily on loans and overdrafts to keep their businesses afloat?

Holding appropriate levels of stock

Monitoring

stocks

Holding excessive stocks has an opportunity cost. People in business have to make big decisions all the time. How much to invest? Whether to expand? Whether to continue? Choosing the right level of stock to hold may not seem such a big issue but for many businesses, and not just those selling perishables, it is.

Opportunity cost is the next best or highest value alternative that has to be foregone. The opportunity cost of reading this text might be studying another subject, or playing on a games console, or watching Liverpool beat Manchester United, or just chilling.

Regardless of the length of time someone has been in business, decisions about how much stock to hold are a major concern. If a business sells from its existing stock of goods, it will have to hold enough stock to avoid feeling nervous. This applies to all sizes of business regardless of whether they are storing stock in a garage or in a highly computerised warehouse. Many businesses now use JIT stock systems but they can go wrong and they put pressure on the supplier to have goods ready "now'. As we have seen, that can lead to quality levels falling.

Have you ever been to a car boot sale and run out of items immediately? Did you misjudge demand? Did you sell at the wrong price? Or have you been stuck there for hours and not shifted a thing until you reduced your prices? Did you have the right "stock"? If you are comfortable with your stock level you may have too much. If you are feeling nervous all the time, you probably have too little.

Even firms who know their business inside out can get stock levels wrong. If a firm loses a sale because they have run out of stock that is not just annoying, it is a waste of advertising, labour and, of course, sales revenue. If a firm has unsold stock for too long, it risks never being able to sell it, perhaps due to technology or fashion changes. It has also spent money that could have been used elsewhere. This is why stock levels must be monitored regularly.

**Boden**

The British fashion outlet Boden opened in 1991, employs 800 people and ships 12,500 parcels out of its warehouse in Leicester every day. It has this advice for customers, particularly those who have not been able to buy an item because it is not in stock. ""The most common cause of bankruptcy among retail outlets is holding too much stock. Even if we wanted to, we couldn't order much more stock than we do currently as we couldn't afford it. It would mean much more "Sale' activity - good for you, but ultimately suicidal for us."

**Questions**

1. Illustrate, using you own examples, the concept of opportunity cost.
2. If stock levels are such a big problem, why don't all firms hold buffer stocks?
3. Why, according to Boden, is 'holding too much stock' the most common cause of bankruptcy among retail outlets?
4. Which is the best stock control system - JIT, buying to order, or holding a buffer stock? (I would hope to see the words 'it depends' somewhere in your answer.)

**chapter is The difference between cash and profit**

**A hotel in Wales**

Owen and Jenna Thomas both lost their jobs and received redundancy payments at the same time. They decided to put the money into starting a hotel business in a beautiful spot in North Wales. They got a loan and overdraft facilities from the bank. They started taking guests in the spring of 2005 and in the first three years they did well. Cash flow and profit were both strong and they were as well off as they had been when working for their old employers.

The summer of 2008 was a good one. Then in the autumn the financial crisis developed and winter bookings dropped away. Cash flow was negative but the couple did not worry because they already knew that they had made a good profit for the year. Even if sales revenue was down a bit in 2009, they would still be profitable.

Early in the new year, they began to receive bookings for the summer. Clearly some people were going to holiday in Wales rather than more exotic places. They could see ways of surviving the coming recession with special offers. But the bank did not wait. It could see from the bank statements that cash flow was negative and it pulled the plug. It withdrew the overdraft facility and refused to consider whether profits might return in the summer.

**Questions**

1. Why did the owners think the business could survive through 2009?
2. What would make the bank choose to withdraw the overdraft when the business still looked profitable?

Profit and cash

Negative cash flow and losses

* Profit is the difference between total sales revenue and total costs. If that figure is negative a loss has been made.
* Cash flow is the difference between the inflow of cash and the outflow, usually in the space of a month. Cash flow may also be negative, but then it may be positive the next month. Usually, cash flow would be negative over a longer period of time if losses are being made.

Sales revenue is the money received from customers. Cash inflow is different - it may include a bank loan, or cash invested by the business owner, or the proceeds from the sale of an asset, e.g. a van or an office building. Similarly, the cash outflow may include dividend payments or a loan repayment, not just business expenses. A profit and loss account measures profit and cash flow measures cash inflows and outflows. They are linked, but different.

Unfortunately for the hotel in Wales, the bank was not prepared to wait to see if a profit could be made in the summer. It took the short-run indications from the cash flow figures to mean that there was no hope of profit even in the long run. It was not prepared to run the risks experienced by hotels in a recession.

Both cash flow and profitability are threatened in a recession. Unpaid debts are more likely then. But unpaid debts are a fact of business life - the business that hasn't had any is very lucky indeed.

Some businesses are much more vulnerable than others to cash flow problems, even if they are likely to be profitable in the long run:

* New businesses are likely to find that sales are slow to get started, especially if they take time to get their marketing strategies right.
* Makers of new, technically innovative manufactured products have to invest a lot of cash up front, spending on R&D and production facilities. They need substantial funds.
* Small businesses, e.g. farmers that rely on a few big powerful customers like supermarkets, may face cash flow problems if they lose just one customer.

Cash is the lifeblood of a business - you've heard this before. Businesses can go without profit for a while; some seem to be able to go without profit for a long time, as at Ocado. This works for as long as investors are prepared to back the business, but without cash a business will not survive indefinitely. Money in the bank is needed to pay wages, expenses and materials. Not paying wages would mean disaster; as soon as materials are not paid for suppliers will stop supplying.

If profit is invested back into a business wisely, especially if it is used in the purchase of fixed assets, then that investment should bear fruit in the future. Purchases of vehicles, of machinery, and of computer controlled systems for stock control or advanced robotic technology, should all create profit in the future, as costs are driven down and profit margins are increased. The purchase of fixed assets is not treated as a business expense in the profit and loss account, so whilst cash balances will be reduced no immediate effect on profits will be recorded.

Investing

Trade credit

Timing of payments

You can see that the difference between cash and profit can be traced to the timing of payments. Business accounting is based on the principle that as a sale is made, it is recorded in the accounts. A sale made in the last month of a financial year, say, December, should be recorded in that financial year, but the money for payment may not be received until February, which is in the next financial year. The assumption is that the payment will be made and contribute to profits earned in December.

The timing of payments complicates the relationship between cash and profit. Materials bought using trade credit will appear in the accounts at the time of the transaction but may not be paid for until a later period. The case study below shows how this might affect cash flow and profit.

**Selling shoes**

Sole to Sole, a shoe retailer, sells in shops by card and cash (both regarded as instant receipts) and to bowling alleys, who take one month to pay. All expenses, including purchases of stock are paid for straight away. The cash flow statement for a quarterly period reveals the following:

|  |  |  |  |
| --- | --- | --- | --- |
|  | January | February | March |
| Cash Sales | £5,000 | £6,000 | £7,000 |
| Credit sales receipts | £7,000 | £5,000 | £6,000 |
| Total | £12,000 | £11,000 | £13,000 |
| Expenses | | | |
| Purchases | 4,000 | 3,500 | 4,500 |
| Wages | 2,000 | 2,000 | 2,000 |
| Other expenses | 1,000 | 1,000 | 1,000 |
|  | 7,000 | 6,500 | 7,500 |
| Total Cash Flow | 5,000 | 4,500 | (a) |

(questions overleaf)

If a business has been trading successfully for some time, some of the profit made, perhaps most of it, can be ploughed back into the business. This money will often be used to cover day-to-day expenditure, i.e. as working capital. This may seem disappointing but could bring additional profit in the future.

The owner or owners of a business may be prepared to inject more capital into the business themselves. This is not treated as trading revenue in the profit and loss account and will not be shown to increase profits, even though that injection may lead to future profits. It is however recorded as cash injected into the business - another reason why cash and profit are not the same thing.

How the numbers work

Survival

**Questions**

1. Calculate the cash flow figure at (a) for March
2. Calculate the total cash flow for the 3 month period. Show your workings.
3. The credit sales for March were £8,000. Calculate the profit for the 3 month period. Show your workings.
4. Why is there a difference between the profit figure and the net cash flow?
5. If the owner had injected another £5,000 into the business in January how much would the difference be between net cash flow and profit? Show your workings.

Cash Registers, a firm selling cash tills to businesses has sales of £650,000 during the year. The cost of purchases and other business expenses amount to £450,000, leaving a profit of £200,000. Sales of £40,000 were made in the last month of the financial year and only £10,000 of that money has been received. Similarly purchases in the last month amounted to £15,000 of which only £5,000 had been paid.

Receipts for the year (ignoring a possible similar situation at the beginning of the year) amount to £650,000 less £40,000, plus £10,000, leaving total cash received of £620,000. Expenditure is £450,000 less £15,000, plus £5,000, leaving a total of £440,000. The profit recorded was £200,000 but the total cash received was £180,000, a difference between profit and cash of £20,000.

Show what you know

A business, in its first year of trading makes sales of £80,000, has total expenses of £50,000. All of its sales were on credit and by the end of the year £20,000 of those sales had not been paid for. Similarly credit purchases of £20,000 had been made and £5,000 of those had not been paid for. Calculate (a) the profit for the business; (b) the amount of cash received, and (c) the difference between the profit and cash received. Show your workings.

The fact is that net cash receipts and profit are hardly ever a problem for firms that are trading profitably. When profit margins are very small then a delay in receiving cash from sales starts to cause problems, as the money is not always there to pay suppliers and staff. When bad debts occur and some customers don't pay at all, and when others pay very slowly, a situation arises that will set alarm bells ringing. It is at this point that overdrafts are used frequently, credit agreements are re-examined, and loans and the factoring of debts may be considered.

No firm can trade indefinitely if making a loss. At some point the owner or creditors, or indeed other investors, will say 'enough is enough'. If the problems are cyclical and the firm is cash rich it may be able to continue trading in the expectation that trade will pick up and all will be well. It is important to realise that ultimately a firm must make profits in order for it to continue to invest, to continue with its trading cycle and in order to make the effort worthwhile. This is why, whilst cash is king in the short term, in the long run, profit matters most.

Chapter 16 **Why businesses fail**

**Selling sportswear**

Two old friends set themselves up in business in the 1970s selling sports wear. The leisure side of this industry was only just beginning to catch on then and their sales were mainly to sports teams. In an effort to broaden their appeal, one of the partners, without consulting the other, bought 5,000 pairs of sports socks from a dealer who was cold calling. This was a bad decision on three grounds;

* trust was destroyed between the partners. In law a decision made by one partner is binding on all partners
* the firm was known for selling football kits, not leisure wear
* the socks only fitted small children. Caveat emptor! Which means, let the buyer beware.

The firm closed down soon after. The sports sock decision lost the firm a large amount of money and also damaged the relationship between the two owners.

**Questions**

1. Consider the reasons why the decision was mistaken. Which was the most important and why?
2. How could this mistake have been avoided?

According to a report from the BBC in October 2010, four out of every five business start-ups ends in failure and often the main cause is either poor planning or a total lack of it. Some businesses that fail, whether they are start-ups or established companies, are unlucky. But usually there are reasons for their failure - and often, the cause is a combination of problems. Most failures fall into at least one of three problem areas:

* Inability to compete
* Being in the wrong location
* Facing changes in market conditions and being unable to adapt.

This chapter takes each category in turn but you will notice that although one failing may stand out from the rest, often there are other less significant problems that have played a part.

Problems with the competition

Competitiveness

It is probably not a good idea to go into business just because you have a little bit of knowledge about the goods or services you are providing. Planning should be detailed and owners must ask themselves if they have the business experience to deal with all aspects of the business. If not, and they don't have a family member to help, then they need to hire someone who does have the necessary experience and that doesn't come cheap.

Problems can come from weak management skills or lack of experience in any aspect of the business. Ineffective market research, poor inventory (stock) management or weaknesses in training could all make the business less efficient and raise costs of production. This in turn will affect profitability. It is not just small and medium sized firms that can be hit by poor management. Very big businesses often face problems and ultimately if they cannot generate cash they will go under.

* Thorough market research, conducted before starting up, a business could get an early warning of intense competition in the market place. Entrepreneurs must take steps to ensure that they do actually have a market in which their product will sell. They may otherwise overestimate expected sales, perhaps due to poor planning. This may be caused by naivety and over-confidence. Studying the market could lead to better planning, sensible production targets and appropriate advertising strategies. This type of

approach would have helped the business in the case study above. If you think about Jack and the fish and chip shop on page 3 it is clear that the previous owners of the shop did not do their market research.

Reputation

Weak

management

• Poor inventory management - the inability of a firm to manage its stocks properly - is a common reason for failure. Business to business (B2B) deals are less likely to be renewed if one firm lets down another. This is because the profits and reputation of the customer firm are directly affected when the supplier fails to deliver. The firm losing out will quickly drop an inefficient supplier, or one that doesn't have the right type of goods, in favour of a firm that can supply quality and quantity as and when required. Reputation is often difficult to establish and no business wants to lose it through the fault of another firm. Individual consumers may be prepared to wait for delivery but in a fast moving world that is becoming less likely as well. Poor inventory management figured in the story of the business supplying board games on page 47. JIT doesn't work unless it is well managed.

* A similar problem - oversupply - can also cause problems. Firms buying in large quantities of inputs, often with the best intentions, e.g. because they were offered discount for bulk buying, can find themselves with deteriorating cash flow.
* Weak management of cash flow may cause a new business to fail very quickly. Remember Pete the plumber on page 72? Because he did not ensure that he got paid as quickly as possible, he ran out of cash to pay for his plumbing supplies.
* As a business grows it may need to recruit staff. This can be difficult and costly but employing the wrong person can be disastrous. Do you have a part-time job? Are you a good employee? Do you turn up on time? Do you meet the general public in your job? Do you have a friendly disposition? First impressions count. Not every business customer or potential customer will be easy to deal with. The first meeting with a potential customer can make or break the deal. Courteous staff are very important to the firm.

Some of the fastest growing firms make enormous efforts to train and treat their staff well because they know that their staff are as important as their customers. Unfortunately some firms don't make the effort and this is reflected in poor customer service and inevitably, a deteriorating reputation.



*Weak management of cash flow may cause a new business to fail very quickly.*

Show what you know

1. Why is efficient stock management important to a business?
2. Business owners with a poor attitude to staff and customers will produce a poor product or service. Discuss.
3. Can a business owner who is responsible for every aspect of the business be efficient?

Location

**Selling snakes**

I was recently asked to advise on the setting up of a business dealing in aquatics and reptiles - exotic species of fish and slimy creatures. The plan was to set up in a busy retail shopping area. I asked the owner how many of his sales would be from passing trade and he replied, 'very few'. Clearly there was no need to be in this area. Not only was the rent relatively high but also there was very little space for parking.

I was surprised to see the level of demand for this type of business. In such a specialised area, customers are usually willing to travel to less commercially busy spots, with better access, to browse the merchandise. Incidentally, I advised that as in all businesses, relevant insurance is a necessity, but in this trade when live creatures are transported from round the world and many don't survive the journey, specialist insurance is essential, and its cost had better be absorbed into the selling price of every 'product'.

**Question**

What other types of business could flourish outside the main shopping areas? Give three examples and explain.

One reason often given for the closure of a business is being in the wrong location. Placing an antiques shop next to a row of '£ shops' selling low value goods is probably not a good choice. But many independent stores are being squeezed from the high street due to a combination of high rents and cut throat prices from large national competitors. Even independent convenience stores that are well away from the high street are being threatened by mini-supermarkets, e.g. Tesco Metro. There are often protests about this, but the popularity of local Sainsbury and Tesco seems to suggest that the decline is irreversible. Some market towns, perhaps conscious of their appeal to tourists, both local and international, have resisted the call for uniformity but this may not be for long.

Competition

Some businesses do make mistakes over location. They set up without doing their research, without even doing footfall counts, or without sufficient advertising of their location. They make choices that defy logic. In busy areas the turnover may not cover the rent for the premises. If it will not cover the other fixed costs, the business is doomed.

Find out more

Look back at pricing strategies in Chapter 4 and the work you did on contribution costing in Unit 1. Work out what measures might be useful for a business that is not covering its costs in a high street location.

Diminishing

demand

Market

conditions

**Location problems**

The results of research carried out by CB Richard Ellis, a property consultant, released in September 2011, suggest that Britain's high streets are becoming increasingly barren as more and more stores close. The report suggested that the decline of the high street was down to a number of factors, including retail business failures (caused by a number of factors) and changing shopping patterns.

Jonathan De Mello, CBRE's head of retail consultancy stated that "the age of giant shopping centres and major regional shopping malls is having a significant impact on small towns and secondary shopping centres." It may not be possible to reverse this trend. The survey found that only four of the UK's top 74 largest cities and towns were able to stem the tide of high street closures. The worse affected town centre was Margate with 37.4 per cent of shops empty. In Rotherham there was a rise in boarded up units of 13.7 per cent in only six months.

The growing North-South divide was evident with 90 per cent of the 25 largest towns with the highest vacancy rates in the Midlands and North. The only positive news was in Manchester where the vacancy rate of 19 per cent is not considered excessive for a large city and is holding up well.

**Questions**

1. For three different types of retail outlet, explain why fewer businesses want to locate in high streets.
2. Given the increasing value of sales coming from on-line selling, to what extent is the location of business premises as important as it used to be? Or is it even more important?

Town and city councils rely on income from business rates. Local business people rely on income to keep them in the area; at the same time their own spending helps to contribute to the wealth of the area. Some of the empty units could be converted into residential space but if an area is to be regenerated it has to be attractive enough for this to be worthwhile. When the economy recovers from the recession, it may be clear that traditional shopping centres can thrive - or not.

**Changing market conditions**

**Night life**

The number of bar, pub and nightclub businesses going bust rose by almost a tenth during the second quarter of 2011, compared with the first quarter. Despite a boost from the Royal Wedding, consumer confidence remained weak, curbing consumer spending on entertainment. Disposable incomes have fallen in real terms and uncertainty over job security means people are keeping their purse strings tight, according to Anthony Cork, a partner at the accountancy firm Wilkins Kennedy. He also added that the rise in alcohol duty announced in the Budget had eaten into profit margins.

Many pub landlords are tied to tenancy agreements that determine the prices they can charge. Add to this the availability of relatively cheap alcohol in supermarkets, the ban on smoking in bars and pubs, and perhaps it is not surprising that trade is falling and insolvencies rising.

**Question**

Have the pub, entertainment and leisure industries been unlucky to see so many closures, or are they the architects of their own downfall?

Supermarkets' ability to buy in bulk and cut prices has affected the profitability of pubs and other outlets for alcohol. These changes in market conditions affect all firms, particularly those in the retail sector, and particularly, the independent sector.

Market conditions refer to the characteristics of a market such as the number of competitors, the level of competition, the market's growth rate, the pace of innovation and the level of demand for the product.

**Questions**

1. Rank the sectors according to the extent of the change between 2007 and 2011.
2. Examine the results for the two least and the two worst affected sectors. For each sector, explain how they were affected by the recession and give reasons for the impact in each case.

Large shopping malls have little room for small independent businesses which cannot compete on price and cannot pay the high rents. Even some of the larger companies fail to survive: either their range of products or their quality fails to bring in enough customers to justify the prominent location. TJ Hughes is a recent example of this. This does not mean that there isn't a place for large businesses at the cheaper end of the market. Despite criticism regarding the sourcing of their products, Primark has established a strong presence in the market.

Market change and competition

Some businesses have the wrong product for the times and there will always be winners and losers in any market place.

* Changes in customer preferences can reduce sales dramatically.
* Some businesses will be unable to compete when more efficient and better managed businesses enter the market and sell for less.
* New technologies change markets too - making some products obsolete.
* Lack of customer demand in a recession, caused by falling or stagnating incomes, is a very significant cause of failure.

Many of the reasons for difficulty in competing have links with aspects of market change. A dynamic business can on its own change the market - think of Dyson and its impact on Hoover and the other manufacturers of vacuum cleaners. But one aspect of market change affects most businesses: recession and reduced spending power have a massive impact. The data from ON5 on business closures shows this. For every business that actually fails there will be many others that report reduced profits.

Some businesses - Domino's Pizza is one - actually flourish during a recession. Their pizzas are attractive to customers who would in better times have eaten out or bought more expensive takeaways. This may account for some of Primark's success: profits may fall in a recovery. But far more businesses are likely to experience difficult trading conditions.

|  |  |  |
| --- | --- | --- |
| Bankruptcies (by Quarter) forced by trading debts | 3rd Quarter 2007 | 1st Quarter 2011 |
| Construction | 380 | 600 (this peaked at 700 per quarter in 2009) |
| Transport, storage and Communication | 230 | 270 |
| Wholesale & retail | 300 | 425 (this rose rapidly during 2011) |
| Restaurants and hotels | 160 | 375 |
| Real estate | 80 | 165 |

Source: ONS

In Chapter 7 on pages 39-41 there is a brief overview of the state of the British economy since 2008, and the effect of that on sectors of industry. Businesses faced massive market change.

**The impact of recession**

Data on business closures is a key indicator of the state of the economy. The table compares sector performance in 2007, when the recession had not yet affected many businesses, and 2011, when most were facing difficulties.

When the economy slows down consumers spend less. People who become unemployed will have much lower incomes. Those in work are less likely to get a good pay rise. They may also aim to save more because of fears of further job losses. So some sectors of the economy are badly hit. Many restaurants will struggle no matter how well run they are.

Similarly, when banks stop lending and place more conditions on borrowers, estate agents and the building industry are going to be badly affected. Demand goes down and supply has to adjust accordingly. Less efficient firms may be the first to fail but others will go too. Transport, storage and communication has been surprisingly resilient given the added problems of rising oil prices. Telecommunications, where there is still huge technological change and interest, has held up.

Recession

The wholesale and retail sector has performed relatively well until the last two quarters of the survey, but it is in this sector that the most concern about debt levels was expressed. Perhaps profit margins have been squeezed as far as they can be. The Insolvency Service, which takes charge of failing businesses, believes that the bulk of bankruptcies will be individually owned, small businesses not covered by limited liability, who have less flexibility in doing deals with banks, making them an easier target for creditors, including HMRC (the tax authorities).

Show what you know

1. From the evidence presented and from your own research and observations explain the difficulties faced by firms when the level of economic activity slows down.
2. Independent retailers have been hit hard by the intensity of competition. Is there anything they can do to survive or are they all likely to disappear?
3. What types of business are most likely to remain resilient, even in a recession?

Failure

**Should I go or should I stay?**

HMV has moved in technology, fashion, live music, and cinemas and has the backing of Sony Music, the Ministry of Sound group and EMI Music. At the time of writing it remains profitable and generates net positive cash flows and is a powerful brand. It is the leading seller of CDs and DVDs in the UK. It is almost 'the last man standing' in its market.

In January 2011 it issued a profit warning and announced a plan to sell 60 stores, in an effort to fight back against internet and supermarket competition. Sales at the HMV chain fell 13 per cent in the 10 weeks to January 1st 2011: the weather drove even more shoppers online. Yet the run up to Christmas is usually the chain's busiest period. It even opened 'pop up' stores in busy locations for that period only.

Waterstones, the book seller, is part of the HMV group and sales there held up relatively well but rumours suggest that HMV may have to sell Waterstones as well.

**Questions**

1. Is HMV a victim of changing market conditions or has it overestimated its potential for sales?
2. Is the decision to sell off 60 of its stores a reflection of poor management of its cash flow position?
3. Is the introduction of off-shoots to its core business likely to breathe new life into the iconic brand? Or should it plan to shrink as sales of CDs will keep on declining?

Section 4 **Managing other people**

**chapter** 17 **Different types of organisational structure**

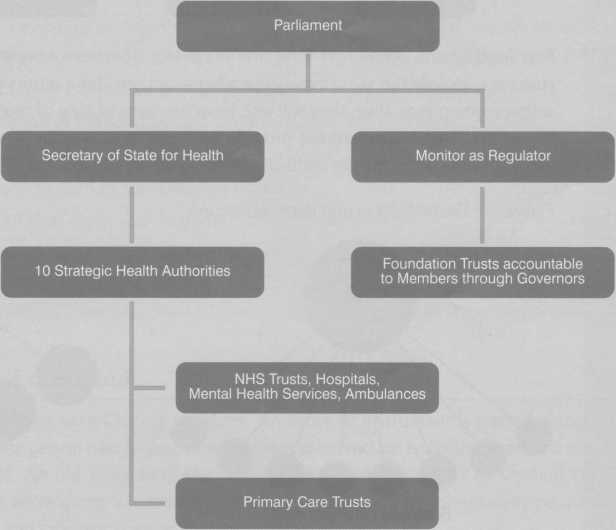
Centralise or decentralise?

**Organisation in the public sector**

The NHS was established in the UK in 1948 to provide a comprehensive health service to improve physical and mental health through prevention, diagnosis and treatment. It was always said that this treatment should be 'from cradle to grave'.

Over the years the organisational structure has changed repeatedly as different political parties have tried to get the best value for money from an organisation that now employs over a million people. The existing structure, which is shown in Figure 14 is set for radical alteration by 2012/13. All countries hope to deliver comprehensive, good quality, accessible healthcare at a cost that society is prepared to pay. Internationally, a good health service can be organised in many different ways, for example using insurance, central taxation, local authority management and the private sector.

*Figure 14*



The management of the NHS has alternated between a centralised structure and a decentralised structure. It is hard to imagine a fully decentralised NHS because ultimately it is accountable to Parliament; also there are huge cost savings to be made from centralised buying. However it is sometimes said that a centralised organisational structure may overlook some of the needs of individual patients.

The latest proposals for change in the NHS organisational structure entail increased power for General Practitioners. This devolvement of power suggests a more decentralised approach. A decentralised structure may mean increasing the number of administrative posts. Patient needs may become a higher priority but at an added cost. Moving back to a centralised structure could leave posts unfilled.

**Questions**

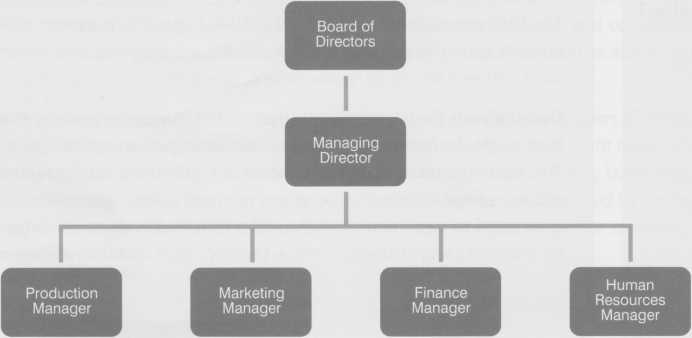
1. How might patient needs be better served in a decentralised NHS?
2. Could the new system benefit some people more than others? Give examples.

In all but the smallest of businesses, an organisational chart shows the way in which the chain of command works within an organisation. As a business gets larger and functions become more complex the structure will not be so simple. Figure 14 showed an organisation chart for the NH5. Many medium sized businesses would have an organisational structure rather like that shown in Figure 15.

Organisational

structures

Figure 15: An organisation chart

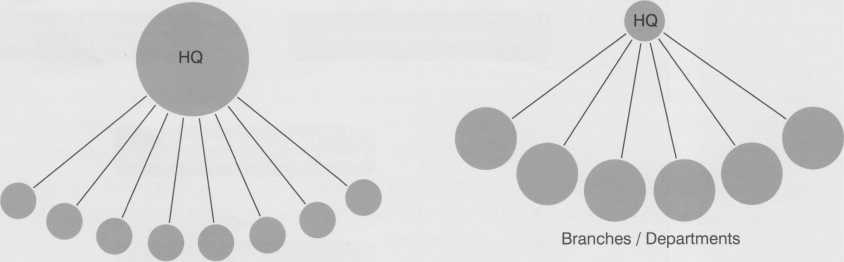


Fast food chains like Burger King and Pizza Hut operate a centralised system which helps them give customers exactly the same experience whenever they visit a particular restaurant. Not only will all stores within a group look alike; they will also have the same quality of food as meals are prepared identically in all outlets. These standardised procedures create cost savings so that unit costs are reduced. Senior managements enjoy greater control over the organisation and there is little room for originality.

Centralised

decisions

Figure 16: Centralisation and decentralisation



Branches / Departments

These decisions are made to benefit the organisation as a whole. The fast food industry franchises many of its outlets so that all the basic organisational details are dealt with locally. At the same time, the managers have to follow very tight procedures which are all centrally controlled and this guarantees the quality and consistency of the brand. An organisation chart for Pizza Hut would show just a few managers at the top, undertaking centralised tasks, and the many franchises operating independently, carrying out delegated decisions locally.

Centralised decision-taking implies that all decisions are taken at the head office.

Decentralised decisions are taken at the point where the decision will be put into effect.

Organisation charts show how lines of authority work and who is accountable to whom.

Franchises are independent businesses that have the right to sell a branded product.

Supermarkets often attract managers who want to be able to challenge themselves by being involved in the decision making process. This is despite the fact that they do not pay top salaries, compared to other similar

sized organisations. They can do this because, for example, Morrisons and Tesco allow managers a degree of autonomy. They are allowed to decide on staffing issues and store promotion, which gives them invaluable experience. This type of experience may be hugely motivational. Also, it allows senior managers to concentrate on group strategy rather than the nitty-gritty of local store management.

The empowerment that is felt by these managers may be transferred lower down the chain as supervisors become involved in the decision making process. Staff are able to use their local knowledge to help stores thrive and can become effective decision makers. Senior managers, based centrally, may not be able react quickly to local circumstances.

Balancing the advantages of decentralisation against centralisation is quite difficult. The choice will depend on the type of firm involved. Many public limited companies (pic's) will rely heavily on experienced senior managers at board level. When the company or the economy as a whole is not doing well, strong leadership will be needed and may be seen as reassuring for staff at lower levels.

Show what you know

1. Why is a more decentralised approach to organisational structure likely to be more costly for a firm or organisation than a centralised system?
2. Is a firm operating an organisational structure that is centralised more likely or less likely to be able to respond quickly to changes in the local environment? Explain your answer.
3. Is Roman Abramovich, the Russian oligarch and owner of Chelsea football club, likely to favour centralisation of the football club or decentralisation? Explain your answer.
4. Consider whether you would prefer to work for a firm that is centrally organised or one that is de­centralised, in each of the following situations:

* As a 16 year old in your first job
* As an eighteen year old after 'A' levels or an equivalent qualification
* As a 21/22 year old with a degree.

The chain of command

You may be familiar with Chinese whispers. An order or instruction is passed along a line, usually by whispering to the person next to you, to see if the end instruction is still the same as it was at the beginning. Often it is not. An old story from the trenches in World War I tells of sending the message, 'send reinforcements we're going to advance', but it gets passed on through so many people that it comes out as 'send three and four pence we're going to a dance'.

If the chain of command is too long, communications get misinterpreted. However if the chain of command is too short the people receiving the message may not fully understand the complexity of the message.

A chain of command shows the way authority and the power to take decisions are passed down within a business. The most senior people are at the top of it, with layers of more junior people beneath them. Figure 17 shows how a manager might pass on decisions to one or two deputies, who would in turn provide appropriate instructions for individual departments.

Figure 17 illustrates a short chain of command and a wide span of control. A wide span of control offers more responsibility to those at the bottom of the chain and thus could be said to be motivational as it offers empowerment. This is not necessarily the same as authority: most of that will be reserved for those higher up the chain. A short chain, by reducing the number of middle managers, may cost less. The hierarchy is flatter, with fewer layers and more opportunities for junior managers to take some decisions. A disadvantage is that it confers responsibility on those who might not seek it, and their performance may suffer.

In some firms the chain of command is product based, for example, a department store where the manager of each department has a degree of responsibility.

Span of control

Figure 17: A chain of command



A chain of command indicates the lines of authority and responsibility within a business. It may be long or short.

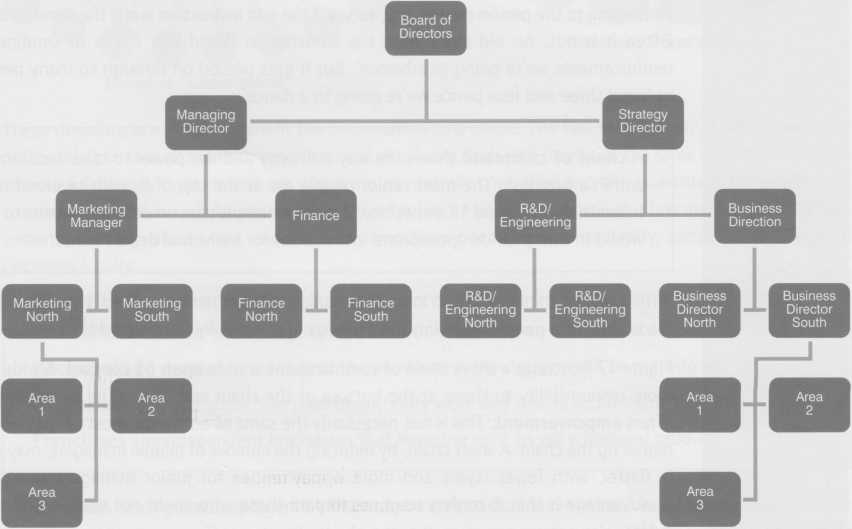
A hierarchy describes the layers of management in an organisation. Each layer has authority over the one beneath. Organisations may be tall with many layers or flat with fewer layers.

Span of control refers to the number of people in an organisation for whom one person is responsible.

Empowerment involves giving subordinates power over their working lives. Employees have some influence on the way they carry out their tasks.

Figure 18 shows how a long chain of command and a narrow span of control might work. A business with a number of operations could be organised with a board of directors, then a managing director and a strategy director, with marketing and finance reporting to the md, and research & development/engineering and business direction reporting to the strategy director. Each of these would have north and south geographically based departments reporting to them. Beneath that would be divisional area departments. This type of management structure could work well for a company operating all over the country.

Figure 18: Long chains of command and narrow spans of control



Hierarchies

Whilst it could be argued that there are too many levels of command in Figure 18, the advantage of such a system is that quality control can be managed effectively. People who work together will get to know each other well and the system may foster good working relationships. Of course, decisions take longer to pass down this type of tall organisational structure.

**The Forestry Commission**

The Forestry Commission cares for 827,000 hectares of sustainably managed woods and forests, and plants over 17,000 trees a year. It is a government department which employs over 3,000 people in Britain.

Many organisations are typically set up in a hierarchical structure. They may be structured by product, function or geography. Department stores, for example are structured by product, e.g. menswear, furniture, cosmetics. UK government departments are usually structured by function, e.g. Health or Education. The Forestry Commission is structured geographically, with a Board of Commissioners across Great Britain and national committees for Scotland, England and Wales.

Geographical structure allows decisions to be made and managed at a regional level. Decision­making is delegated down the hierarchy so that there is a measure of decentralisation. Each country manages its own estates and oversees conservation activities.

There are also benefits from centralisation, with some internal policy decisions made at the top of the hierarchy. This ensures consistency, for example, when implementing international rules for sustainable forestry management. Centralisation also provides the benefits of economies of scale, e.g. central departments for Fluman Resources, Finance and Information Services. Sharing services in this way reduces costs.

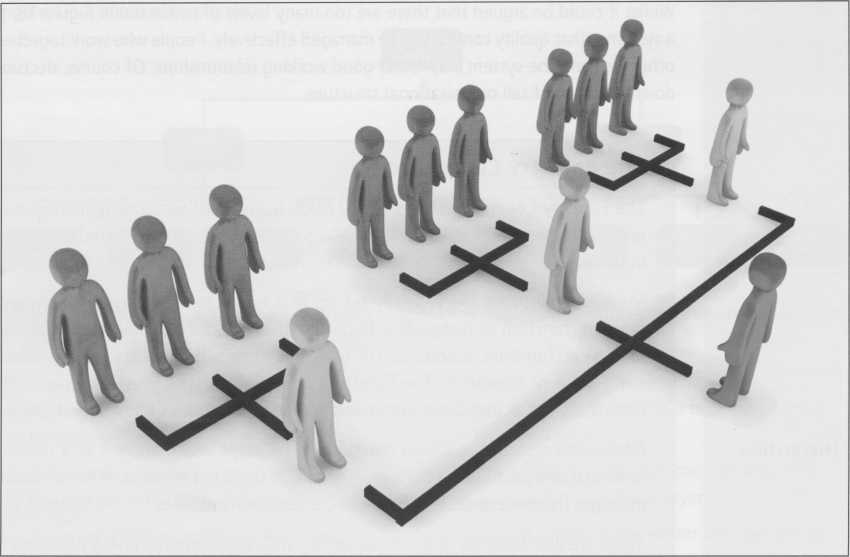
Some hierarchies have many layers and a narrow span of control with each manager being responsible for only a few workers. These tall organisations allow tighter control and supervision but may stifle workers' initiative. The Forestry Commission has a flat organisational structure with few layers and larger spans of control. Communication is generally quicker and enables creative approaches and the freedom to explore new options. Employees are able to take responsibility for their decisions.

**Questions**

1. What is meant by the term 'hierarchy'?
2. Organisations can be structured by product, function or geography. Explain each of these, using an example to illustrate your understanding.
3. Contrast the benefits received by the Forestry Commission from centralised decision making and decentralised decision making.
4. In your own words explain why the Forestry Commission benefits most from a flat organisational structure.

Businesses vary enormously. No single model of organisational structure is suitable for all businesses. In particular businesses need to decide between a flatter and a taller hierarchy. To create an effective organisational structure, a business needs to consider the following:

* The competition - research them, even if only by looking at published sources of information.
* The industry - is there a standard model? For example, the motor industry tends to work on a regional model.
* Regulation - certain aspects of the law may require a firm to set up in a particular way. This can range from payroll and taxation procedures to parliamentary law, for example, in the pharmaceutical industry.



A dear organisation structure will show who is responsible to whom.

* Coals - the organisational structure should enable a firm to achieve its goals; a clear structure will outline how each person or each role will be undertaken, for example who is responsible to whom.
* Investors - firms need to create a favourable impression to potential investors. Alongside business plans, budgets and forecasts a clear organisational structure will help show how a firm hopes to achieve its objectives.

Find out more

In recent years schools and colleges have adapted their organisational structures, which have traditionally been fairly flat. There are many tasks and roles that were previously carried out by teaching staff; this model has now changed. Some of these tasks and roles are now being carried out by non-teaching staff, mainly administrative staff. Find out what has changed in your establishment, why it has changed, and whether it has changed for the better.

Present a short group report to your class and discuss your findings.

%

**chapter is Recruitment and training**

**AgustaWestland sheds 10% of workforce**

The helicopter manufacturers needed to make 375 employees redundant. Cuts in defence spending worldwide were reducing the size of its market. The company employed 3600 people in the UK, but most were producing military helicopters. Delayed orders meant tough competition as they and other producers scrambled to get what work there was.

Orders were still rising for civil helicopters, however. And there were hopes of more exports to come. Offshore oil exploration was creating some demand. So a restructuring process was required. In its announcement, the company said: *"These steps*... *will place our UK operation on a strong footing and enable us to keep the skills needed for the UK to retain a viable helicopter capability... we are extending our capabilities in civil production and competing for export programmes*, *both areas where the government has shown considerable support; these are the keys to AgustaWestland's future."*

Redundancies were announced about the same time at BAE systems. Other employers that wanted to recruit people with scarce skills hurried to get in touch with the redundant employees.

**Questions**

1. Why would it be important to 'keep the skills needed'?
2. Skill shortages are often a problem for businesses. Give two reasons why this might be.

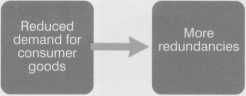
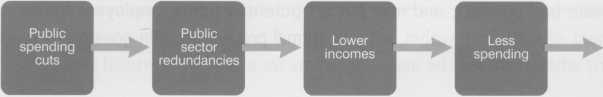
It might seem odd to start with redundancies when thinking about recruitment. In fact, the difficulties involved in recruiting people with scarce skills make it very important to retain employees who already have them. But redundancies are important for other reasons too: when they are a real problem in the economy, it will be much easier for employers to find the kind of people they want.

Redundancies

Recession

On September 2011, the UK government announced job losses of 80,000 in the three months to July, a rising trend. The jobless total at that point stood at 2.51 million or 7.9 per cent. Youth unemployment rose in the same period by 78,000 to 973,000.

The government's commitment to cutting back the public sector and reducing public borrowing made job losses inevitable. During 2011 pay rose by 2.8 per cent (2.1 per cent if bonuses were stripped out) while inflation was above 5% so real wages fell. Interest rates were low.



There are consequences for firms seeking to recruit. As the supply of labour goes up, relative to demand, then prices (wage rates) fall. There was a rise in the minimum wage in October 2011, (up from £5.93 per hour to £6.08 per hour for employees aged 21 and over with corresponding rises for younger workers). But there was little pressure on wage rates. Employers were able to get good quality staff for any vacancy for less than would be the case in times of relatively full employment.

In those conditions, people seeking work may need a higher level of skills and qualifications even at lower rates of pay. It is a buyers market. Employers will be looking for various skills from potential employees and, because of the number of potential applicants for each post, will be more likely to get them. Those seeking work will have to be even better prepared, show greater ingenuity and a positive attitude if they are to be successful. A downside for employers is the likely increased cost of sifting through hundreds of applications.

Show what you know

1. What is meant by the phrase 'a buyers market' in the context of the labour market?
2. Why might some employers be looking for employees with few formal skills or qualifications?
3. In periods of relatively full employment, employers try to keep key workers even when they are not fully occupied. Why might they do this?

Is there a vacancy?

Recruitment

The process of recruitment should start with an assessment of whether there really is a vacancy to be filled. When someone leaves, it is not always the case that the post needs filling. If roles can be changed and working practices can be altered, the business may not need a new recruit. A job analysis should be carried out - a process of describing and recording aspects of a job, and specifying the skills needed to do it. This will help to show whether the work can be reorganised and continue without recruiting.

Businesses often find themselves planning a smaller workforce. They may want to introduce new labour- saving technologies, or just see a way to produce more efficiently. The preferred way to deal with this is natural wastage - simply not replacing the departing employee. It avoids the many miseries associated with redundancies.

Internal or external candidates?

Sometimes internal recruitment is possible. If there is an employee who is appropriate for the job in question, the employer is spared the expense of advertising and processing applications. The candidate's knowledge of the business will be useful too. But before that decision can be made, everyone concerned must be aware of the law on fairness.

Employment law states that:

"An employer has the legal responsibility to ensure that no unlawful discrimination occurs in the recruitment and selection process on the grounds of sex, race, disability; age, sexual orientation, and religion or belief Equality of opportunity is an integral part of the recruitment and selection process."

Source: ACAS

Employers should not promote someone from within an organisation without going through an application and interview process. If they do, there may be a complaint from another employee to an organisation such as the Advisory, Conciliatory and Arbitration Service (ACAS). This is likely to be costly for the firm concerned; it may create bad publicity, and may put off potential future employees from applying. In practice the appointment of staff from within, without formal procedures, still goes on in some firms and industries, particularly when there may be many applicants for a widely advertised job.

External recruitment

Larger firms are more likely to recruit externally, even though they probably have a bigger pool of possible internal applicants, who could be given the opportunity to apply. External recruitment, especially for larger firms, is more likely to attract a higher calibre of candidate, particularly when the post that needs filling is a challenging one.

Internal recruitment means that the employer looks for potential applicants within the organisation.

External recruitment means advertising a job vacancy widely enough to attract good applications from outside the organisation.

There are a number of Acts of Parliament that deal with discrimination. Whether they are recruiting internally or externally, employers must be aware of these. Of course, an employer can look to recruit externally but end up selecting an internal applicant.

Some organisations have rules regarding when a post will be advertised internally or when it is to be advertised both internally and externally. Such decisions will normally depend on the seniority of the post; the more complex the job and the higher the skill level required, the more likely it will be that the job is advertised to external as well as internal applicants.

The recruitment process

It is important that firms have good recruitment and selection procedures. If the process ends with a poor appointment for the organisation, the employer could be faced with increased labour turnover and increased costs. Also, the morale of other workers may fall if they have to cover for an inefficient colleague or don't enjoy their work because of a poor atmosphere.

Labour turnover refers to the number of employees leaving the business each year, as a percentage of the average labour force.

Recruitment systems should be:

* Efficient - cost effective in terms of methods and resources.
* Effective - produce enough suitable candidates to ensure the identification of the one best fitted for the job.
* Fair - ensuring that right through the process, decisions are made on merit alone.

The job analysis will focus on the nature of the work and the skills required. A job description should then follow - a set of tasks, functions and responsibilities that make up a role; this may also include the qualifications needed to fill the post. Finally a person specification is required - a profile of the type of person needed to do the job. Often person specifications include the education and qualification required of the applicant, their training and experience and the personal qualities that would be appropriate. These characteristics may be split into two categories, essential and desired.

Job analysis

Job descriptions set out all aspects of the work involved, define the responsibilities of the employee and show how they would fit into the organisational structure of the business.

Person specifications describe the personal qualities that the applicant will need to be successful in the job.

Show what you know

1. Why do some firms make appointments from existing staff, without considering external advertising?
2. Is it more or less advantageous for a firm to appoint after an external recruitment process rather than an internal one? (I hope your answer starts with 'it depends'.)
3. If an external candidate is appointed to a post, when there are internal candidates, what extra qualities might that candidate bring to the post, and what problems might (s)he be faced with?

Increasingly, human resource management (HRM) departments are using recently developed software to digitise their employee information systems. This integrates payroll systems with workforce management information and makes it much easier for managers to use each individual member of the workforce in the most productive way. If in a large business an employee becomes redundant in one department, theinformation about them can be used to redeploy them to another department where their skills and personal qualities will still be of value.

Attitude or skills?

Skills

In small firms the use of press advertising and Jobcentres is often omitted in favour of word-of-mouth. The advantages of lower costs are obvious, and hiring someone who is a 'known quantity' can sometimes reduce staff turnover if the new member gets on well with the other staff. In small firms working relationships tend to be closer and more personal, and attitudes can be especially important. But there can also be indirect discrimination against disadvantaged groups.

Recruitment by word-of-mouth may help recruit people with a positive attitude but not necessarily those with the highest skills. In small firms wages may be lower and training less frequent. There are low levels of unionisation and less job security and it is these firms that are most likely to use word-of-mouth recruitment. But it may be hard to find the best possible recruits without advertising externally, widening the pool from which the employer is selecting.

Training

**Who's best?**

Ron Jepson ran his own handyman business. He was a jack-of-all-trades; he hoped he was a master of some of them as well. His order book was full and with the help of the local college he was able to take on an assistant, for a kind of apprenticeship. There was no agreement that a job would be available at the end of the year's course but it became clear to Ron that the only way he could progress further was to take on a full time employee.

Mike Dobson was the apprentice. Ron's wife said that she had never met a young man so polite and attentive. His timekeeping was good and he learnt quickly. Ron was not so sure. Mike had a habit of taking odd days off work, usually on Mondays, which made Ron doubt Mike's commitment. He was also very quiet, not even discussing the weekend's sport.

Ron wondered whether he should advertise the post, knowing that Mike might not be too pleased, or stick with Mike as he had already been trained.

Advise Ron, identifying the advantages and disadvantages of each approach and drawing a conclusion.

Some organisations want their recruits to have very specific skills and experience. This will mean that little time and money needs to be spent on training. Other organisations look for the kind of person who has a good attitude to work and to colleagues, and will fit well into a team. The argument for this approach is that recruits can always be trained in the necessary skills, but attitudes are hard to change.

How much training

Appropriate training will enhance the quality of the staff and their output, whether it is administrative, manual or technology based. Well trained staff may well seek to further their progress elsewhere but that is no reason not to train them. A firm that does not keep its employees aware of the latest and best advancements in the workplace will ultimately lose orders and profit.

Training can make employees feel valued as well as giving them a specific skill. They are likely to be better motivated if they feel the firm is looking after them. Some staff may need to be persuaded about training if they are comfortable with their situation and don't like change. Managers should be sympathetic but should still insist that they are up-to-date with the latest techniques.

Training can take many forms

* Induction training helps new recruits to settle quickly into the organisation by making sure that they know as much as possible about the work, the company policies and their terms and conditions of employment.
* On-the-job training allows the business to concentrate on the skills that they most need. It works well when the skills required are particular to that organisation. It is often appropriate in the service sector and can range from 'howto deal with customers' to the provision of IT. training for administrative posts. This type of training may initially hinder the speed of work of those who carry out the training but at the same time good working relationships may be forged.
* Off-the-job training is carried out externally. Although there are fewer apprenticeships than in the past, many firms prefer to train off the job. Sometimes employees spend one or two days a week at college acquiring specific qualities and qualifications. This is probably best suited to younger employees, as they are cheaper to employ and government sponsored training schemes will reduce the cost of training to the employer. This approach works well in the manufacturing and construction sectors. The type of training arranged will depend on the type and size of the organisation.

Firms who value their staff and treat them well will be the long-term beneficiaries in terms of efficient, well trained staff who enjoy their work and working environment. Well motivated staff will keep staff turnover down.

Show what you know

1. What is the difference between on-the-job training and off-the-job training?
2. If training is costly is it worth spending thousands of pounds on specialist courses for staff?
3. What is the link between well motivated staff and low labour turnover?

Labour turnover

Labour

turnover

Labour turnover measures the rate at which employees leave their jobs.

Labour turnover =

Number leaving per year  
Average number of employees

x 100

Consider the following statement:

"A single event of recruitment is likely to hove more effect on o smoll firm thon on o lorge one."

Appointing a new person inappropriately in a business that has 15 employees is likely to impact on every employee. In a business that employs 1500 people the ripples are less likely to be felt. All appointments should go through a rigorous procedure, so as to avoid poor appointments, which may in the end lead to increased labour turnover.

Many businesses carry out regular appraisals of their employees, perhaps setting targets and discussing ways of working. Before starting on a round of appraisals, the business should know the percentage of labour turnover. A low labour turnover rate, reflecting the ability to retain staff, is an indication that the firm is doing something right. Employees are more likely to be happy in their work, less likely to take unwarranted time off and more likely to help increase the effectiveness of the organisation. If labour turnover is high, appraisals can be used as an opportunity to uncover possible causes and remedies.

High labour turnover is costly because new employees have to be recruited and this usually requires some training. Low labour turnover will be a significant advantage in maintaining competitiveness.

**chapter i**9 **Motivation**

**Life at Google**

Google's approach to motivation is quite unusual. At their headquarters in California free food, pool tables and massages are available to employees. They are encouraged to spend 20% of their time working on projects that interest them. Recreational facilities are spread about the 'Googleplex' as it is called. Employees are encouraged to sit around on the bean bags discussing their work and thinking up innovative ideas. The company was formed in 1999; it has grown spectacularly and is perhaps the most successful in its field.

Google says its company culture is built around 'mission, innovation, fun and reward'. Quotes from the company include "you can make money without doing evil," "you can be serious without a suit," and "work should be challenging and the challenge should be fun."

The Google way to reward employees is to target small teams that are performing exceptionally well. The company aims to deliver rewards just at the right time, i.e. immediately they have achieved a goal. Sometimes the reward will be free company shares.

**Questions**

1. Why do you think the Google strategy works? Think of three reasons.
2. What is it about the company that makes this philosophy successful?
3. Would other companies ever be able to make it work?

A number of studies have been carried out to discover why people work. Besides money, there are many reasons why people go to work. Many people have worked to put money in their pockets and meals on the table but they have also established firm friendships. Many men had hard working lives because conditions at work in the past were often not good but they looked forward to seeing their mates. They enjoyed the sense of belonging to a group, and to a company.

Abraham Maslow was the first to examine the needs of people at work and to find out what might motivate them. Maslow placed these needs in a hierarchy:

Maslow

* Physiological needs, such as the basics of food, drink and good working conditions.



* Safety needs, such as job security and safe working conditions.
* Social needs, such as a sense of belonging and being loved, working with colleagues who provide support for you in a group situation.



Figure 19: Moslow's hierarchy of needs

* Esteem needs, such as being given recognition for doing a job well.
* Self-actualisation, such as being promoted or being given more responsibility in order to achieve full potential.

Maslow's hierarchy of needs identified the needs that relate to obtaining basic requirements to sustain life, as well as the higher order psychological needs that can make work satisfying.

Maslow argued that the needs on the bottom rung of the pyramid or hierarchy had to be satisfied before a person could move to the next level. This means that before an employee can be 'productive' at work the employer must pay the employee enough money to enable him or her to survive (the physiological needs). The employer will also need to provide for the safety needs before the employee can maximise potential.

Each level of needs is dependent on the one before. Critics of the theory argue that is very difficult to say when a particular level has been achieved. How, for instance, are social needs for friendliness, love and belonging to be achieved if employees don't work together? Some employees work from home, or are out on customer calls; their only contact with the firm is an electronic one.

The hierarchy of needs

Esteem needs are achieved by gaining the respect of others and gaining recognition. This can be met by praise or a monetary reward but is it necessary to have achieved, for example, love and belonging, the social needs, first? Self actualisation - the need for a person to fulfil their potential, is a worthy aim but for some people, this may never be achieved.

People in the workplace are motivated by many different things and it would be wrong to suggest that if a person does not fulfil their potential they cannot be motivated. Maslow's work was detailed - much more than just the diagram in Figure 19. The theory should not be cast aside because not everyone quite fits the model. Businesses do value and make use of Maslow's theory. If managers can identify where an employee is on the hierarchy, they have a starting point for deciding on the reward that is needed.

Taylor's scientific management

F.W. Taylor

Maslow, writing in the 1950s, was the first to look at employees' needs, and how they related to each other. But he was not the first to consider motivation. It is 100 years since Frederick W. Taylor carried out research on the factors that motivate individuals. Taylor still has many followers.

Taylor's research was carried out in a steelworks in the USA. He was a well educated man, who spent some time working on the factory shop floor, gaining rapid promotion. He was well placed to see that the work routine at the time was haphazard; that workers often brought their own tools into work and made their own decisions as to how a job should be done.

Taylor sought to improve industrial efficiency by studying each task carefully and training workers to carry them out according to scientific principles. He believed that workers left to their own devices would do as little as possible. He proposed a clear demarcation line between management and workers, which had not previously existed. Workers were to be rewarded by having pay linked to productivity.

Scientific management as set out by F.W. Taylor called for work-study analysis of each job, to determine the most efficient ways of producing. He based his organisation of the work place on the scientific data and created an incentive by linking pay to the level of output.

Successful but controversial

Taylor's ideas were forerunners of what in the mid-20th century came to be known as time and motion: each worker was observed and each element of work was timed. His methods were hugely successful but much criticised in some quarters; some people felt that workers were being treated like machines. His way of working didn't allow for differences in human performance. This, according to critics, dehumanised the person carrying out the job.

Many of Taylor's ideas were followed slavishly and successfully for three-quarters of a century. His initial observations were carried out at the Bethlehem Steel works in the USA. His methods were responsible for raising pig-iron production by almost 400 per cent per day, yet his approach of 'one best way' to do the job was not popular among employees, despite their benefiting from higher pay if they did well. Many factory owners were critical and did not use his methods.

The American singer Billy Joel, writing in the 1980s in a song called Allentown, included the lines 'our graduations hang on the wall, they never really helped us at all, they never told us what was real, iron and coke, chromium steel'. And so it was in the USA, at least until the the steel works closed down. Taylor gave them 75 good years.

Show what you know

1. Outline the advantages and disadvantages to using Maslow's Hierarchy of Needs as a means of motivating a workforce.
2. F.W. Taylor believed that the main motivational force in the workplace was the financial reward for being productive. What benefits does this bring to (a) the employer and (b) the employee?
3. In your opinion is Taylor's Scientific Management approach to work and motivation the right one? Explain.

Herzberg

Motivation

Factors

A crude summary of Taylor's work would suggest that financial incentives motivate workers and some would say that is true today. Other studies suggest that there is more to motivation than just monetary reward. Frederick Herzberg, a psychologist, began studying motivation shortly after the end of World War II. From observations he made after studying a group of professional engineers and accountants he developed the two-factor Motivation-Hygiene Theory of job satisfaction. Herzberg's findings led him to believe that the following Motivation Factors gave people job satisfaction:

* Achievement
* Recognition
* Work itself
* Responsibility
* Promotion
* Growth

Herzberg argued that workers would be more productive if these factors were in place. But equally important were the Hygiene Factors, which needed to be in place to prevent workers from becoming dissatisfied. The Hygiene factors were not Motivators, but they did matter.

Hygiene

Factors

* Company policy and administration
* Supervision
* Working conditions
* Pay and benefits
* Relationships with co-workers
* Personal life
* Status
* Job security

It is important to highlight that according to Herzberg, an improvement in hygiene factors is not likely to motivate an individual but if they are not met or if there is some deterioration in them, there will be a fall in productivity.

Herzberg identified and distinguished between the Hygiene and Motivation needs of employees. He showed how hygiene needs would avoid dissatisfaction while motivation needs would actually contribute to job satisfaction.

Herzberg's

research

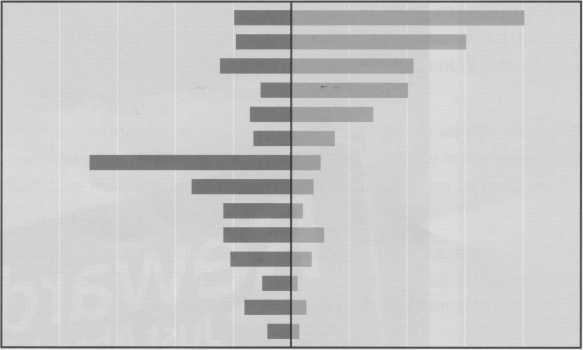
*Figure 20: Satisfaction and dissatisfaction*

Achievement Recognition Work itself Responsibility Promotion Growth

Company policy and admin.

Supervision Work conditions Pay and benefits Relationship with co-workers Personal life Status Job security

Factors that lead to extreme dissatisfaction Factors that lead to extreme satisfaction



50% 40% 30% 20% 10% 0% 10% 20% 30% 40% 50%

% frequency of events leading to satisfaction or dissatisfaction

Herzberg's theory aligns more closely with Maslow than with Taylor. Improving pay and conditions should remove some dissatisfaction but will that be enough? If in a year's time, for instance, a higher pay claim is made and refused then presumably the dissatisfaction returns. Herzberg's study was on a small group of workers with specific skills. Follow up studies on different groups of workers have failed to replicate Herzberg's findings. What has stood the test of time is the link between Herzberg's work and that of empowerment which is covered in Chapter 20.

**Motivating staff at The Body Shop**

The late Anita Roddick was famous for her ideas on how to motivate her staff. She said:

* All staff should ask questions and look for better ways of working.
* Listen to new ideas - they keep everyone interested and help them to innovate.
* Respond to suggestions.
* If profits are growing, share them with the staff.
* Make heroes of the staff who perform well.
* Be family friendly.
* Ask staff "how can we ennoble your life?" and "how can we make your spirit sing?".
* Allow staff to grow.

Her overall motivational philosophy was 'staff are motivated by being given the opportunity to have ownership of the goals and values of the company'.

Anita Roddick withdrew from involvement with The Body Shop before she died, but her ideas on motivation were influential. Some of them were quirky and probably wouldn't suit everyone, but they were in use when the company was growing at its fastest.

**Questions**

1. What connections are there between Anita Roddick's approach and the motivation theories? Find at least three and explain each one.
2. How might Anita Roddick's ideas work in (a) a construction company, (b) an airline and (c) a supermarket?
3. To what extent is money a motivating force?
4. According to Herzberg, pay and benefits do not motivate workers but recognition and achieve­ment do. Outline the thinking behind this view and consider its relevance to today's workforce.



Firms need to set out quite clearly how they will reward their employees.

Special tip

Don't just learn the theories. Make sure you can apply them in practical contexts. Don't forget about McGregor's Theory X and Theory Y in Unit 1. Show how Taylor, Herzberg and Maslow's ideas work in practice, using lots of examples and practical applications. These are all the theories you need to know for the Edexcel course; the examiners are always interested when work from other theorists is mentioned, but no questions will be set on their work.

Financial incentives

Pay as a motivator

I bought my first car from an old friend. I remember him saying "one down, seventeen to go". He had to sell 9 new cars and 18 used cars in order to qualify for a bonus. This would be on top of the commission he got from each sale. It was a very tough target; he never made it but he said that no one ever did. To me that was demoralising, but to him it was something to aim for. As long as he was ahead of his fellow salesmen he didn't mind. So no bonus was awarded.

A bonus is a one off payment in recognition of the contribution made to the firm - in the case above, selling a certain number of cars.

Commission is a payment of a percentage of the value of each product or service sold.

Pay is important to people; it is also important to employers as it is often the biggest single cost to a firm, regularly accounting for more than 50 per cent of total costs in some businesses. Pay can also be a source of unrest if employees feel they are being treated unfairly.

Firms need to set out quite clearly how they will reward their employees. They need to be transparent if they want to avoid a lot of unrest and dissatisfaction. This doesn't mean to say everyone will agree with every decision but at least staff will know the basis of that decision. Often people are paid a basic wage and may qualify for 'extras' depending on the type of work. Employees need to believe that they are being rewarded fairly.

The minimum wage in the UK at the end of 2011 was £6.08 an hour for employees aged 21 and over. Many hundreds of thousands of workers are paid minimum wage, from shop workers to care home assistants, from farm workers to hairdressers. The increase in 2011 was 15p. For a 40 hour shift that is an extra £6 per week, not a lot for the individual, but some firms said it would lead to job losses. However, some said this in 1999 when the minimum wage was introduced. This minimum rate is a payment for the amount of time employees spend at work, i.e. a time rate. It provides little in the way of an incentive.

Paying employees an overtime rate for work done over and above the standard time may be an incentive. Many factories would pay their operatives time-and-a-half for working on a Saturday morning and double time for working on a Sunday. Part-time work and split shifts are now more common so there are fewer incentivised rates for overtime.

The minimum wage

A good rate of pay attracts reliable employees and often works as a rationing device. If the initial rate is high some people will not apply for vacant posts as they realise they don't have what is required. Others will chance it if clear indications of the necessary experience and qualifications are not set out.

**You can take a horse to water...**

George Thompson owned a number of newsagents and over a period of 25 years was successful. For a man with little formal education he did remarkably well. He used to believe that his employees needed to be persuaded to work hard by some form of stimulus and that without it they wouldn't work as hard.

George had an employee of the month award, voted for by his customers; he would encourage competition amongst his paper boys and girls by rewarding the ones who delivered their papers within a set period of time and without any complaints from householders. The rewards were simple and probably sounded a bit silly, to adults. A free ice cream to the first paper boy back, and an extra day's pay if there were no complaints in a month, were typical rewards. He even got his staff to believe that not deducting money from their pay when the till didn't balance was a reward.

George rewarded staff for loyalty and was always generous at Christmas. He used to praise highly and had high expectations of his staff. Few let him down. He treated customers well and his staff better. He was fair and would always check on staff when they were ill. He had a uniform for his staff which he paid for and he set staff work-related targets - he used to call them his 'goal of the month'. (He thought this was very funny.) George was often surprised at how successful he was. Perhaps you wouldn't be!

**Questions**

1. George had never heard of any motivational theory or theorist. Of the motivational theories you have learnt, which one(s) fit most closely to George's philosophy? Explain your answer.
2. In what way would you reward staff who are loyal to you?
3. What do you think were the main reasons for George's success in business?

Performance related pay

Profit related pay

A good initial rate of pay may be part of a remuneration package that might also include profit sharing. Profit sharing encourages employees or partners in a business to be as productive as possible as they will (usually) get a predetermined, equal percentage share of the profit. Similarly employees may get a bonus related to the profits made; usually a proportion of the profits are set aside for this use. This is known as profit related pay.

At John Lewis all the profit remaining after investment is ploughed back into the business is shared amongst the employees. This percentage has been as high as 15 per cent of earnings. The main problem with these last two types of financial incentive is that they are paid to everyone regardless of their level of performance.

This can prove frustrating for hard-working employees who see less hard working employees getting the same reward.

A similar sounding concept which is actually quite different from profit sharing and profit related pay is performance related pay. Here workers are judged and rewarded individually, according to how they have performed. This incentive has become more popular in some industries where there has been a move away from industry-wide agreements to local agreements, allowing for a greater focus on individual and team performances.

Profit sharing gives employees a percentage of profits as well as basic pay.

Profit related pay relates a proportion of pay directly to the level of profit. In the UK there is a tax incentive to pay this way, but it has not been widely adopted.

Performance related pay usually consists of a bonus related to employee achievement of some kind. The targets against which performance is measured could for example be related to output or quality or customer service.

Employees are usually subject to an appraisal or a review or assessment each year where their performance is measured against some known, pre-established criteria. Depending on particular schemes, a successful employee may move up the pay scale or receive a small cash payment or bonus. Anyone who does not match up to expectations receives only the basic wage or salary. There is a presumption that employees will be motivated by this type of performance related pay. However there is a danger that some awards may appear to be subjective if targets are unclear. Sometimes employees come to expect a reward of some sort regardless of their performance. (This seems to apply in banking.)

In the past, it was common for employees to be paid piece-rates, which meant paying according to how many items had been produced. Taylor saw this as the best way to motivate workers. This approach is now little used even in manufacturing situations. However many people still get a commission payment if they make a sale.

Piece-rates had their attractions for hard working employees, as long as there was a plentiful supply of work to be done, i.e. there were enough pieces to make. The method didn't work very well if there was a bottleneck in production or if there were problems with delivery and rigorous quality control procedures were required.

Show what you know

Piece-rates are wages paid according to the amount produced. Fruit pickers are sometimes paid this way.

1. Explain 'commission' and give an example of its use.
2. Why might some employees view profit sharing and profit related pay as unfair?
3. What are the essential features of a good pay scheme?
4. What is a piece-rate system and what problems might there be for employees on such a system?
5. Why is performance related pay easier to establish at local rather than a national level?

**chapter** 20 **How managers can get the best from their staff**

**Why not delegate?**

*We are sorry if you ore inconvenienced but we will be closed for the next fortnight as we are on holiday/our daughter is getting married/there has been a bereavement in the family*

How often do you see a notice like the one above? Each set of circumstances is a valid reason for disruption but is it enough to lose two weeks' business, especially if there are other, perhaps junior, members of staff available to help? What better way could there be of getting the best from your staff than giving them responsibility and empowerment? To know that you are trusted to deal with customers and suppliers, to pay money into the bank and to keep records, could be rewarding for an employee.

**Question**

Of course not everyone is able to get that opportunity but what does it say about the quality of staff if an employer is unwilling to make that decision?

Delegation means passing authority down from a superior to a subordinate (from boss to employee). It gives a boost to the confidence of the subordinates. It makes them feel valued. It can be carried out at different levels. Delegation is a step on the way to empowerment, where an employee is allowed to take control of some decision making. If an employee is given delegated authority only when 'the boss' is busy, or feels overworked, they may feel resentful.

Delegation is probably easier when the superior works closely with the subordinate as they should each know the other's capabilities. Even here there are rules to follow. Planning is a key element; delegation should not be attempted unless there is complete clarity about what is being delegated, otherwise confusion will reign. Tasks should be discussed and, where appropriate, explanations provided.

When an employee is given authority and responsibility to implement a decision, there is some degree of empowerment. Employees who have been empowered have some control over how they achieve their work objectives. They work autonomously without management direction.

Delegation means passing responsibility on to someone lower down the hierarchy, so that decisions are, as far as possible, taken by those who have to implement them.

Consultation

Communication

The business climate is often challenging; recession or an increasingly competitive market can mean that orders and profits are hard to come by. Businesses that have performed well in the past are quite likely to do so in the future but sometimes they have to make important decisions that affect staff morale. Remuneration is always a contentious area and decisions to cut back on staff, to reduce the working week and to cut wages, are never welcome.

Consulting the workforce usually helps and is never a bad thing. Not consulting the workforce is rarely a good idea. Employees who find that they are going on a 3 day week, for example, want that decision to be explained to them. They might not like it but they might see that it is the best decision in the circumstances if there is a rationale behind it. Employers who go out of their way to keep staff informed, to have consultation sessions and to report back to their staff, are more likely to get their backing than those managers who issue instructions from on high.

**Not consulting**

In 2003, The Accident Croup, a personal injury claims management company, became insolvent and went into administration (in common speech, it went bust). It told its 2,400 employees that they would all be made redundant by text message. The staff were so disgusted that they took away all the computer equipment when they left.

**Question**

Imagine that you are going to be asked to work a 3-day week for the next 4 months. Explain your reaction, (a) if you are consulted and (b) if you are not.

Team work

Organising

production

The phrase 'throw a spanner in the works' means, literally, damaging a motor engine or gearbox by putting a foreign object into the moving parts. This could be a way of describing the disruption of production lines in car factories. The phrase is used to mean ruining a plan or deliberately causing trouble.

Long established vehicle manufacturing plants with big assembly lines have had a history of disruption and disagreement with trade unions. Assembly lines made for big increases in productivity when they were developed in the mid 20th century. But they resulted in many employees having just one or two tasks, which were repeated over and over again. When Japanese cars began to sell well in the West, they were generally found to be more reliable than the home-produced competing cars. The entire motor vehicle industry started to rethink. In time manufacturers of all kinds of products were influenced by what followed.

**Renault**

At Renault in the 1970s there was a record of spectacular conflicts, growing absenteeism and a high level of labour turnover, along with an increase in product faults that had to be rectified. This led to a form of team work. Initially assembly line workers would rotate between 2 or 3 positions. This was followed by giving small groups of workers control of the complete assembly of a mechanism, e.g. the gearbox, whilst it moved down the line. Sometimes this included preparation and rectification procedures.

Not everyone at Renault was happy with this. The Work Study department felt that it went against the principle of having each employee specialise in one operation. In time, the company adapted new technologies, automating some processes whilst having small groups of employees standing by to intervene when problems arose. (Robots were gradually being introduced at this time.)

Similar trends gradually appeared in most of the Western vehicle manufacturers' plants. Often, teams were made responsible for maintaining quality assurance.

**Questions**

1. Why did production systems where each employee specialised in one task cause problems?
2. Explain why teamwork has been associated with a trend towards higher quality and reliability in consumer products.

The principal function of team work is to improve the quality of work whilst increasing productivity, by being better organised and getting together to solve problems. This was made possible by having fewer operatives on the assembly line and fewer replacement operatives. Quality control and replacement of defective parts, as well as cleaning, were kept within the group. Workers would become skilled in a wider range of tasks and would develop greater pride in their work; there would be fewer disagreements. This has worked well for many businesses but introducing new ways of working entails very careful planning and willingness to accept change. This kind of reorganisation cannot be adopted lightly.

Flexible working

There are two aspects to flexible working:

* Being prepared to take on a range of different tasks within the production process.
* Accepting a range of employment patterns, including part-time as well as full-time, temporary as well as permanent jobs, and varying the hours worked to suit the situation.

In a flexible workforce, many employees will be multiskilled. They will be able to carry out a number of different processes. They may have a good understanding of the equipment they work with and be able to do minor repairs when needed. They will probably have had some recent training to help them get used to new technologies. They are likely to be familiar with lean production methods.

Multiskilling

This approach will fit neatly with delegation, empowerment, team work and quality assurance. For many businesses, it has helped to increase productivity because it encourages employees to adapt readily to changing circumstances. It may also be associated with a decentralised approach.

Some businesses want to move from a taller to a flatter hierarchy, which means delayering. In other words, a whole layer will be removed from the hierarchy, usually people who might be seen as middle managers. This will often require a degree of flexibility and some multiskilling, as responsibilities are redistributed amongst the workforce.

Flexible working can mean being prepared to take on a number of different tasks, and also, being able and willing to work irregular hours, part time or temporarily.

Multiskilling involves employees in being trained to undertake a range of different processes. Delayering means moving to a flatter management structure by removing a layer from the hierarchy.

**Buoyant Upholstery**

Mike Aramayo had been Managing Director of Buoyant Upholstery for five years, during which time he had eliminated losses and moved the company into profit. Sales and profits had increased but margins were very tight and competition was fierce. A series of meetings at Board level led him to believe that he needed to cut costs further.

Buoyant already had a flexible workforce, bringing temporary overseas workers into the UK at busy times of the year, and Mike didn't think there was much room for increased efficiency in the production area. The company had seven directors, all but one of them with over 20 years experience in the furniture business; each director had his or her own team. Mike wanted to delayer but instead of removing a complete level across the firm he decided to amalgamate four areas into two, combining the sales department with the commercial department, and the design department with the development department.

Two of the directors were made redundant (one was happy to go; after 35 years service he got a bumper payout) but the other director was not so happy. Ten other management and administration posts went as well. Cost savings were apparent immediately but the training budget increased as teams were amalgamated. Some employees' responsibilities increased and many became more empowered.

The new design team were quick to adapt with staff relishing the chance to make important decisions and to see them through. The new marketing and sales department found the flatter structure more challenging. However, one of the senior managers found it difficult to take responsibility for an increased number of employees. Instead of decisions being made more swiftly, there were areas of confusion and some communication problems in that department.

On reviewing the changes Mike became aware that not all employees reacted similarly to increased responsibility, despite an increase in the remuneration package. He appreciated the personal impact the changes were having on individuals and made a mental note to offer more support.

*(questions overleaf)*

Flexible employment patterns

Flexible

working

hours

**Questions**

1. What are the main reasons why firms choose to delayer?
2. At Buoyant Upholstery the removal of part of the management structure led to greater empowerment for some managers. What does empowerment mean in this context?
3. Why might a flatter structure lead to more, not fewer communication problems?
4. Suggest reasons why the changes appeared to have worked in one of the amalgamated areas but not the other.

Some businesses operate a policy of flexible working in terms of hours worked, days worked, split shifts and even working from home. These can benefit certain groups of workers - especially those who need working hours that are family-friendly. Part-time work is becoming much more common in the UK labour force, partly to accommodate the needs of families, but also to help businesses adapt to falling demand for their products. This trend has helped many businesses to cope with recession.

The proportion of woman in the workforce continues to increase and with it the need for greater flexibility. Many men and women appreciate flexible working hours. Students looking for part-time work are often open to changes in their work pattern and may prefer split shifts. Older workers may work for 3 days a week or on a mornings only basis. Many people have older family members to care for and try to fit their working hours around their needs.

There are a number of reasons why the traditional factory and office hours are no longer the norm, besides those already covered, for example:

* changes in technology require different approaches
* businesses facing stiff competition may look to cut costs by adopting a flexible approach.

Without doubt, the employer or manager who seeks to cater for the needs of staff and wants to be fair will get a better response from most employees. Employees who regard their working conditions as good are much more likely to work productively than those with grievances. Managers cannot resolve all problems but they can reduce the chance of working hours being one of them.

Non-financial incentives

Traditional assembly line work where each person specialised in one task led to many people doing seriously boring work. Other kinds of jobs can be boring too, and many of these are not well paid either. In order to keep morale up and costs down, different methods of working may be used. You will already be familiar with some of these - such as team work and quality circles, delegation and empowerment. Other developments have included:

* Job rotation allows employees to change tasks from time to time. They will move from one job to another, in a planned and organised way, getting any necessary training when they make the switch. This increases the range of their experience and can provide variety, new skills and enhanced motivation. This should reduce boredom although it may lead to a temporary fall in productivity while the worker learns a new skill. It fits in well with teamwork and makes employees more versatile.
* Job enlargement involves reorganising the various jobs to be done, giving each individual several different tasks, perhaps making them responsible for putting an entire product together. This enlarges the scope of the job and enhances the role of each employee in the production process. Job enlargement could be said to be a form of horizontal loading - more tasks of a similar nature. Employee satisfaction should rise.
* Job enrichment expands the process vertically. An employee might be given responsibility for planning, ordering materials, quality control, completing the job, and maintenance. This is more challenging and may not be suitable for everyone. It brings possibilities of recognition and achievement that may be a big motivating factor. This approach is not confined to manufacturing production; in fact it can be better suited to the administrative side of a business.

Managers have to weigh up the relative effectiveness of these non-financial incentives, in order to make jobs more rewarding and get the best from their staff. No one type of job enhancement is going to improve matters for everyone. The nature of the job, the type of industry and the availability of workers will all need to be considered. The case study, Buoyant Upholstery, illustrates how flexibility can work in a wide range of ways, and the importance of fitting the changes to the needs of the people concerned.

Show what you know

Job

enhancement

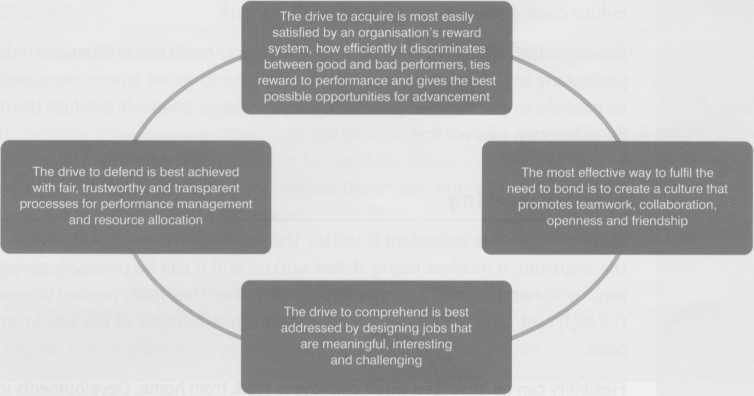
1. To what extent might the measures discussed here contribute to meeting a) Maslow's higher order needs and b) Herzberg's motivation factors?
2. Why might job enhancement fit in well with making all employees responsible for quality, or a policy of continuous improvement?

Motivation again

A major research study tried to find out what motivated employees. It concluded that managers got the best from their employees by satisfying four basic motivating drives. These are:

* The drive to acquire (obtain scarce objects, including intangibles such as social status)
* The drive to bond (form connections with individuals and groups)
* The drive to comprehend (satisfy our curiosity and master the world around us)
* The drive to defend (protect against external threats and provide justice).

The study focused on four commonly used workforce indicators that measure motivation. These are: engagement, satisfaction, commitment and intention to quit. The study found that an organisation's ability to meet the four fundamental drives explains, on average, about 60 per cent of employees' variance on these four motivational indicators.



Finally, workers felt that their immediate line manager had a big part to play in their motivational performance.

**Questions**

1. Which of the above 'drives' can best be satisfied by performance related pay?
2. Which one of the four drives could best be satisfied by team working?
3. Which one of the four drives could best be satisfied by job enrichment or job rotation?
4. In your opinion can any of the four drives be satisfied by empowerment?

Chapter 21 **Reducing labour costs**

**The Nigel Clare Network Trust**

The NCNT is a national UK charity that delivers practical support to families where a child's life is limited by quality, lifespan or both.

Recently The NCNT moved out of its Headquarters offices in London and adopted a flexible working structure based on working at home or at clients' sites. Despite the initial setup costs and ongoing support costs, there have been significant savings in annual operating costs.

The quality of client services actually improved as well and twenty per cent more families were supported. All staff now work at and from their homes but they meet on a regular basis for face- to-face team meetings, usually held in local business centres.

Source: Adapted from Wisework - making flexibility work

**Questions**

1. What are the benefits of flexible working for the NCNT?
2. Are there any disadvantages arising from NCNT's arrangements?
3. How has the advent of telecoms networking systems helped firms become more flexible?

Some businesses can raise prices without losing demand. But many will find that they lose customers if they do try to increase the price. In a period of no growth or slow growth, it is unlikely that many industries will be able to raise prices without this having some effect on demand. In these situations firms will look to reduce costs, to help maintain their profit margins.

Cutting costs

Economic history would tell us that the easiest way to do this is usually to reduce labour costs. This applies particularly to the service sector, where most businesses are labour intensive. But in manufacturing it may be possible to invest in equipment that requires fewer people to produce the necessary quantity of output. So either way, jobs are lost.

Flexible working

Making employees redundant is usually the last thing a firm or organisation considers. It can be costly in the short-run; it involves losing skilled workers and it can be politically sensitive. NCTN found a different way, by teleworking and hiring meeting rooms when they really needed to meet. This immediately removed the high cost of office space in London. This is one example of the way in which flexible working can cut costs.

Flexibility can be increased when employees work from home. Developments in computer technology make it less important for some workers to be at a central location. The ease of communication, through emails, social networking sites and video conference meetings such as skype, enables communication with people on the other side of the world. Some of the money spent on travel will be saved and the business doesn't have to provide permanent work stations for all employees.

There are several good ways to use a flexible workforce:

* by having split shifts - this works well for bars, takeaways and restaurants
* by bringing people in at short notice and paying them the same rate as everyone else. This is particularly useful for supermarkets
* by offering their workers short-term contracts. This helps to cut costs as they will have fewer statutory rights.

no

For example, a person on a contract for less than a year does not have any pension rights. Once the contract ends, the business has no need to re-employ that person. Often a contract is for only 3 month's duration and the cost implication for the firm ends at the end of that time.

Flexible contracts

Contracts and flexibility

Many firms will stipulate the number of hours an employee has to work but not the timing of those hours or even the number of days they have to be at work. This gives employees some flexibility when they need to make appointments or to make child care arrangements. However this system can also work against the employee. If the employer requires their presence when the business has a lot of work, this may be at a time that does not suit the employee.

For the business, flexible working can have many cost advantages:

* it may be able to employ first rate staff who would not otherwise be available
* having a contented workforce increases productivity and enables the business to cut its unit costs
* having people who can be called in whenever they are needed saves having to pay a full time employee who might not be fully occupied all the time
* it may be possible to retain able employees by creating working arrangements that suit them, when otherwise they might move elsewhere.

In law, employees who have worked for an employer for at least 26 weeks are entitled to ask for flexible working hours if they have responsibility for children under 17 or act as carers. The idea of flexi-time and of staggered hours should be of benefit to both firm and employee. It is worth re-iterating that if an employee believes the employer to acting in a caring and fair manner, the response from the worker will outweigh any inconvenience suffered by the business.

**Sundays**

Fifty years ago few business premises opened on a Sunday. Little sport was played. Times have changed! As society began to accept Sundays as a good day for leisure activities, so the need for more workers on the Sabbath became apparent. Employees were encouraged to work on a Sunday with the offer of higher wage rates. Then the law changed to make it easier for retail outlets to open on Sundays, creating increased demand for part-time workers and blurring the need to pay more for working anti-social hours. Probably, many of the people who now work at weekends don't consider their hours to be particularly anti-social.

**Questions**

1. List and explain at least four ways in which costs could be cut by flexible working.
2. Explain why retailers have generally welcomed the chance to open on Sundays.

Part-time working

There has been a shift in attitudes towards part-time working: 7.8 million people in the UK are either willing to work part-time or have to (figures for July 2011), out of a total workforce of 29 million. The biggest advantage for businesses is the cost saving: they can employ part timers at just the times when they most need them.

Not everyone likes part-time work and in 2011,1 million people were working part time because they could not find full time work. At least, for them, part time work beats being unemployed.

For a business, part time employment facilitates many aspects of flexible working, in that it allows businesses to make use of people just when the need is greatest, and keeps overall employment costs down. Some

employers allow people with family commitments to work when they want to. Often this allows them to get a good recruit at a rate of pay that is less than the market wage for the job. It may please the employee as well.

Staff dismissal and redundancy

Cutting the workforce

*If a business is struggling some people may have to lose their jobs and be made redundant.*



Sometimes it becomes clear that particular employees are costing the business more to employ than they are actually contributing to output and sales revenue. This may not be the fault of the employee. The business may be struggling in a shrinking market, in which case the business may have to shrink too, just to stay alive. People who lose their jobs in this situation are being made redundant.

When an employee has actually made mistakes or failed to work in the way expected, the business will want to dismiss them. This is very different from redundancy.

* It may well be that this employee should never have been hired in the first place, because they were not the right person for the job.
* Or it may be that they had the right qualifications but they have not worked as expected.

Fair and unfair dismissal

When it becomes clear that the employee has significant shortcomings, managers must act in accordance with employment law. They must first give a verbal warning, making clear to the employee the ways in which they have been performing poorly and saying what they will have to do to keep the job. If this does not bring improvement, a second verbal warning is required, followed if necessary by a written warning. If the employer has followed these procedures and the employee can be shown to have performed badly, then dismissal is fair.

Sometimes an employee believes that the dismissal is unfair. Some people who are made redundant think this too. They may take their grievance to an industrial tribunal, which may find in their favour. This is expensive for the employer and usually, if the employee has a case, the business will seek to settle the dispute by paying some form of compensation before too many lawyers get involved.

Avoiding redundancies

Recently in the public sector there has been a wave of redundancies, including some in the armed forces and the caring professions. In the private sector, BAe Systems has announced job losses exceeding 3,000 at its plants in Lancashire and Yorkshire, amid howls of protest.

Redundancies cut costs in the long run. But most businesses want to avoid creating bad relationships with stakeholders and in particular, with the workforce and the local community. What are the alternatives? Most businesses will make every effort to reduce labour costs through all the forms of flexible working described above. They may also try various marketing tactics and new technologies. They may consider moving production abroad, which can cut costs dramatically but this is fraught with difficulties and unlikely to lessen the need for redundancies.

Voluntary labour turnover or compulsory redundancy?

If the conclusion is that redundancies are inevitable, the key component of a successful strategy will be discussion and communication. Managers must talk to trade unions or other representatives of the workforce. Together they may be able to find solutions that are acceptable.

* To some extent it may be possible to reduce the labour force by natural wastage, i.e. not replace employees who retire or leave for their own reasons.
* Maybe some staff would agree to voluntary redundancy, but some of these people may be quite valuable to the organisation, so it is never simple.
* Favourable redundancy payments may help reduce the numbers without any compulsory redundancies being needed.
* For further redundancies, a consensus may be found, whereby the outcome will be seen as fair and equitable. For example, a process of last in, first out may be used (i.e. making the most recent recruits redundant). This may not rid the firm of its least productive workers but it should help to avoid a poisonous atmosphere.

When there is a need to shed staff, the job must be done in a way that is seen as fair. It is also important to try to ensure that remaining employees do not become too fearful, starting to act like rats leaving a sinking ship. Here again, communication is important.