

**COURSE  
GUIDE**

**ENT 303  
SMALL SCALE BUSINESS MANAGEMENT**

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## **INTRODUCTION**

The course Small Scale Business Management (ENT 303) is a core course which carries two (2) credit units. It is prepared and made available to all undergraduate students in Entrepreneurship Programme, in the Faculty of Management Sciences/Department of Entrepreneurial Studies. This course is a useful material to you in your academic pursuit as well as in your workplace as managers and administrators.

## **WHAT YOU WILL LEARN IN THIS COURSE**

The course is made up of twenty (20) units, covering areas such as:

- Scope and nature of Small Business Management
- Business goals and characteristics of Small Business enterprises
- Basic concepts of Management
- Management principles; Organizing, planning, staffing, controlling, directing functions in Management
- Marketing strategy and planning – definition of planning, importance of planning forms/kinds of planning and illustrate the flow of planning decision in a small business organisation master plan, role of marketing in small business organisation,
- Definition of strategy marketing and marketing task to an entrepreneur, stages in the procedure of marketing strategy planning.
- Market analysis in selection of market posture, coordination and control of business activities strategy revision and continuity psychological barriers to marketing strategy planning
- Sources of information – definition internal and external source of information (Federal government and its agencies, state and local government as external sources of information
- Elements of an information system, advantages and procedures involved in developing records retention programme, uses of some information tools such as manuals, reports and forms,
- Ratio analysis and the limitations of ratio as a tool; budgeting and breakeven analysis – definition, budgeting process problems of budgeting preparation, kinds of budgets and the importance of budgets administration;
- Illustrate how Break-Even chart is constructed, changes associated with the chart as any of the variables change.
- Nature of the Marketing Mix- Price, Product, Place and Promotion

The Course Guide is meant to provide you with the necessary information about the course, the nature of the materials you will be using and how to make the best use of them towards ensuring adequate success in your programme as well as the practice of

small business management in the society. Also included in this course guide is information on how to make use of your time and information on how to tackle the tutor-marked assignment (TMA). There will be tutorial sessions during which your facilitator will take you through your difficult areas and at the same time have meaningful interaction with your fellow learners.

The course consists of:

- Scope and nature of Small Business Management
- Business goals and characteristics of Small Business enterprises
- Basic concepts of Management
- Management principles; Organizing, planning, staffing, controlling, directing functions in Management
- Marketing strategy and planning – definition of planning, importance of planning forms/kinds of planning and illustrate the flow of planning decision in a small business organisation master plan, role of marketing in small business organisation. Definition of strategy marketing and marketing task to an entrepreneur, stages in the procedure of marketing strategy planning.
- Market analysis in selection of market posture, coordination and control of business activities strategy revision and continuity psychological barriers to marketing strategy planning
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- Budgeting and breakeven analysis – definition, budgeting process problems of budgeting preparation, kinds of budgets and the importance of budgets administration.
- Illustrate how Break-Even chart is constructed, changes associated with the chart as any of the variables change.
- Nature of the Marketing Mix- Price, Product, Place and Promotion

## **COURSE AIMS**

The main aim of this course is to equip you with adequate information on the concept and nature of Small Scale Business Enterprises, its characteristics and its roles in an economy. The course also aims at making you have a greater understanding of the

## **OBJECTIVES**

At the end of this unit, you should be able to:

- explain the scope and nature of small business management
- describe business goals and characteristics of small business enterprises
- understand the basic concepts of management
- discuss the management principles.
- Know how to develop a Marketing strategy and plan– definition of planning, importance of planning forms/kinds of planning and illustrate the flow of planning decision in a small business organisation master plan, role of marketing in small business organisation.
- Understand the concept of Market analysis in selection of market posture, coordination and control of business activities strategy revision and continuity psychological barriers to marketing strategy planning
- Know the concept of a Sources of information – definition internal and external source of information (Federal government and its agencies, state and local government as external sources of information
- Explain the Elements of an information system, advantages and procedures involved in developing records retention programme, uses of some information tools such as manuals, reports and forms.
- Understand the nature of Ratio analysis and the limitations of ratio as a tool
- Explain and develop a budget and breakeven analysis – definition, budgeting process problems of budgeting preparation, kinds of budgets and the importance of budgets administration.
- Illustrate how Break-Even chart is constructed, changes associated with the chart as any of the variables change.
- Discuss the Nature and concept of the Marketing Mix- Price, Product, Place and Promotion

## **Course Materials**

Major components of the course are:

- Course Guide
- Study Units
- Textbooks
- Assignment Guide

## **STUDY UNITS**

There are three modules of 17 units in this course, which should be studied carefully.

### **MODULE 1**

- Unit 1      Management of Small Business
- Unit 2      Characteristics and Business goals of Small Business Enterprises
- Unit 3      Need for Small Business Enterprises
- Unit 4      Basic Concepts in Management
- Unit 5      Management Principles
- Unit 6;      Marketing Strategy and Planning

### **MODULE 2**

- Unit 7;      Strategic marketing Planning Process
- Unit 8;      Market Analysis
- Unit 9;      Marketing Mix; Pricing Policies and Strategies
- Unit 10;      Marketing Mix; Product
- Unit 11;      Marketing Mix; Channels of Distribution
- Unit 12;      Marketing Mix; Promotion

### **MODULE 3**

- Unit 13;      Sources of Information
- Unit 14;      Elements of an Information System
- Unit 15;      Ratio Analysis
- Unit 16;      Budgeting and Break-Even Analysis
- Unit 17;      Break-Even Chart

## **ASSIGNMENT**

There are many assignments in this course and you are expected to do all of them by following the schedule prescribed for them in terms of when to attempt them and submit same for grading by your Tutor.

## **TUTOR-MARKED ASSIGNMENTS**

You are expected to submit all the TMAs to your Tutor for grading on or before the stated deadline. If for any reason you cannot complete your assignment on time, contact your tutor before the assignment is due, to discuss the possibility of extension. Extension may not be granted after the deadline, unless on exceptional cases. The TMAs usually constitute 30% of the total score for the course.

## **FINAL EXAMINATION AND GRADING**

At the end of the course, you will write the final examination. It will attract the remaining 70%. This makes the total final score to be 100%.

## **SUMMARY**

This course, Small Scale Business Management (ENT 303) will expose you to issues involved in small business management and its roles in the cooperative society. On the successful completion of the course, you will have been armed with materials, expertise and skills necessary for efficient and effective management of a small business enterprise in relation to the cooperative society.

## MAIN CONTENT

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- Unit 6;      Marketing Strategy and Planning

#### MODULE 2

- Unit 7;      Strategic marketing Planning Process
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- Unit 13;      Sources of Information
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## **MODULE 1**

Unit 1	Management of Small Business
Unit 2	Characteristics and Business goals of Small Business Enterprises
Unit 3	Need for Small Business Enterprises
Unit 4	Basic Concepts in Management
Unit 5	Management Principles
Unit 6;	Marketing Strategy and Planning

## **UNIT 1 MANAGEMENT OF SMALL BUSINESS**

### **CONTENT**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Definition of Management and Small Business
  - 3.2 Nature of Small Scale Business
  - 3.3 Role of Management in a Business Decision
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor-marked assignment
- 7.0 References/Further Reading

#### **1.0 Introduction**

In this course (ENT 303), we will focus our attention on the process of establishing, organizing, managing and planning of a Small Scale Business. But to enable us to proceed and properly guide our thoughts, there is a need for us to understand the nature and concept of a Small Scale Business, and Management nature of a business decision.

#### **2.0 Objectives**

At the end of this unit, you should be able to;

- Know the meaning of Management and Small Scale Business
- Understand the concept of Management and Small Scale Business
- Identify the role that the nature of management has in Business decision

### **3.0 Main Content**

#### **3.1 Definition of Management and Small Business**

Before we give the definition of management, it is well to point out that one of the most important activities of human beings is managing. And the idea of managing the resources of a group started even since human beings started coming together and working in groups. This is important so that the objectives of the group can be attained through proper linking of the various activities being performed by the group members. As organizations, particularly formal organization like business organizations, ministries, schools including universities become large the task of the manager starts getting bigger and more complex. And the aim of the manager is to promote excellence. Management is a word used by different people with varying meanings. The noun management is used as a collective noun to refer to all those who manage within a organization. That is why in an organization there are different people occupying different positions and seeing to it that the resources of such organizations are put into effective use. There are also those managers that assist other managers to perform their functions. They are all managers. The word management can also be used to separate a special class of people in an organization from other classes. You should have heard such statement as, 'the management of the organization has taken a decision concerning the demand of the workers for higher pay'. Such statement is referring to those people that take decisions, whether a temporal decision or a final decision.

In trying to give a precise definition of management, it is always faced with problems. This is because of the interest and background of the person giving such definition. The accountant will like to see management in terms of cash flow: how much the organization is expending in other to get revenue or returns, as well as the timing of such expenditure and revenue. The marketing manager sees Management in terms of analyzing the consumer needs with a view to bring out a product or service capable of satisfying the needs and at a profit to the organization. The personnel manager on his own interest will regard management as employing suitably qualified candidates to fill existing vacancies and motivating them to work as a team toward the attainment of organizational objectives. We can go on and on.

##### **3.1.1 Definition**

Weihrich and Koontz say that management as a process is designing and maintaining an environment in which individuals, working together in groups, efficiently accomplish

selected aims. This is a basic definition which needs to be expanded in the following ways:

(a) As managers, people carry out some functions. And they are employed to carry out the specific functions. These functions are commonly referred to as managerial functions. We shall be looking at these managerial functions one after the other in subsequent units of this course. These functions are planning, organizing, staffing, leading and controlling among others.

(b) Management applies to any kind of organization. This is another nature and purpose of management: Management is not restricted to any organization like the Nigeria Bottling Company Plc. Any organization, if human and other resources are there calls for management. Consequently, management is needed in a philanthropic organization, in the church, in the mosque, in the Lion's club, in a football team among others.

### **SELF-ASSESSMENT EXERCISE 1**

You are required to study your environment. List five profit making organizations and another five non-profit making organizations where management is practiced.

(c) Management is important to any level in an organization. In other words, whatever position you find yourself in an organization, you will feel the presence of management. Those that practice management by carrying out the functions of management are called managers. Management is also of importance to them. They need to understand it and appreciate it so that they can have depth of what they are doing. Without this, their efforts become shallow and haphazard.

(d) The aim of all managers whether a senior manager or a junior one is the same. It is to make surplus or what some people called profit. Making surplus demands that the right decisions are made so that the resources available to an organization are used without wastage. All resources have values and the values are always expressed in monetary terms: Naira and Kobo.

Consequently, when you are making use of organizational resources, you are spending money. But the money is being spent because you want to get revenue which is also expressed in naira and kobo. But the manager needs to find out whether the amount he is receiving is more than the amount of money that he is spending. If this is the case then there is surplus. If contrary is the case, it means that the organization is making loss. This is dangerous because such organization may not be able to pay salaries and wages of workers, buy raw materials with which to make goods or provide services, pay for its electricity and water charges among other demands. In a non-profit organization, efficiency in the use of resources is also demanded. Remember, we have earlier agreed that management is practiced both in profit and nonprofit making organizations. Even though profit/surplus is not supposed to be emphasized in a nonprofit making

organization, they should at least break-even. You might have heard of the word break-even point. It is the point, simply put, where revenue is equal to the amount of money being spent. All nonprofit making organization should aim at this point since by the nature of their operation, they are not supposed to charge their customers so much in other to realize surplus.

(e) Managing is concerned with productivity. These demands create something that is of value to the customers, but the higher the volume of production, the better for the organization. This is because with increased volume, the unit cost of the product is going to be lower. This is so because there are two main types of cost. The fixed cost and what is known as variable cost. The fixed cost such as the cost you pay for machine, erecting buildings etc. All these costs are there, whether you are producing just one unit of a product or you are producing million units of the product. The variable cost as the name implies, vary with the quantity that you are producing. If you are to produce few units, you pay less compared to a situation when you produce higher volume. It is the addition of the fixed cost plus the variable cost that give you total cost. When you have increased productivity, this means that this number will divide the total cost and what you get is the unit cost. That is, the cost for one unit of the product. This cost will be smaller than the one that will arise if you are producing a smaller quantity. This is because the smaller quantity will again divide the total cost. The manager, therefore, always looks at the situations where he will produce more so that the unit cost will always be smaller.

## SELF-ASSESSMENT EXERCISE 2

From our discussions so far, take a sheet of paper and write two statements. One statement, showing the nature of management and the other statement showing the purpose of management.

### **3.2 The Nature of Small Business**

In the Nigerian economy and in all other economies, small businesses litter the economic landscape, provide employment opportunities for people and contribute significantly to economic development. In terms of quantity, they are larger than big businesses. Everywhere we go in our environment we see them. No well-meaning Government can ignore their importance because of their nature and their importance in development planning and management.

#### **3.2.1 Definition of Small Business**

Small business is not easy to define because the definition conceptual problems. The problems arise mainly because of the perceptions of those defining small business. You may use your own qualitative judgement to define a small business. The small urban based beer distributor who sells beer in the evenings is obviously a small business operator. The small hair dressing located in urban Lagos is also a small business concern. A small business in America is not the same as a small business in Nigeria because the two nations are not at the same stages of growth.

Even within Nigeria, the definition of small business varies between the different industries. Members of different associations of small business also see small business from various angles which suit their purposes. Because of the need to present an acceptable broad definition of small business, we shall define small business as one that is independently owned and operated and is not dominant in its field of operation.

You will quickly realize that the underlined words are very important whenever we are defining small business. They focus on the ownership, operations and their scope of influence in the environment. In other words, small businesses do not dominate their various industries.

### **3.2.2 Identifying A Small Business**

Although we have succeeded in defining a small business, we need to go a step further to provide a framework that will enable us identify small businesses in our environment. We need to establish the criteria that distinguish a small business from a big business.

Some of the criteria are:

#### **Initial Capital Outlay**

Initial capital outlay refers to the financial resources that are required to start up a business. If the initial capital outlay required to start a business is small then that fact alone may lead us to conclude that a small business requires a small amount of money to start. For example, with as low as N3,000 (three thousand naira only), a newspaper vending business can be started. Also, a road side kiosk may require a total initial financial outlay of about N7000 (seven thousand naira only) to start. However, on the other hand, if a large sum of money say N50,000,000 (Fifty million naira only) is required to start a business, then that business is not a small business. Rather it is a big business.

A very important point you need to know in using initial capital outlay criteria to distinguish a small business is that there is no specific amount that constitutes the dividing line between a small business and a big one. For example if a trader purchases a luxury bus for use in transportation for the sum of N20, 000,000 (twenty million naira only), one may be tempted to think of the trader's business as a big business. But in the real sense, a transporter who has only one bus in operation cannot be said to be in big business. On our part, we need to use our own judgement to fix an amount which divides a small business from a big one.

#### **Number of Employees.**

Another criterion that you can use in distinguishing between a small business and a big business is the number of employees that the business has. A business that has four (4) employees obviously is a small one. Another business that has 3,000 employees

obviously cannot be described as a small one. Again we run into problem of what number of employees makes a business a small one. There is no exact number and this gives room for qualitative judgement. In the past, early writers on this topic saw a small business as one whose total staff strength does not exceed 50. Today, that number is no longer acceptable as the discussions on small business continues to change.

## **Ownership Structure**

Ownership structure is another criterion that can be used to distinguish between a small business and a big one. You know that ownership structure of business can vary widely. A business can be owned by an individual and run on a sole proprietorship basis. Again, a business could be run as a partnership (two or more people combine to form a partnership). At a much higher level, a business can be run as a private limited liability concern with shareholders as foundation owners. And at a much higher level, a private limited liability company converted into a public limited liability company. You will be able to see from our discussion so far that in context, it does appear that small businesses will be owned largely by individuals or a group of individuals. For example, a small restaurant can be owned by a man, his wife and children. That type of ownership structure makes it a small business. Also two or three lawyers can team up to start a law practice. Again the ownership structure makes it a small business.

## **Type of Technology Employed**

Because of their size, small businesses employ relatively simple technology that is easy to acquire. This is so because of the huge capital outlays involved in the acquisition of modern technology. Small businesses cannot afford to employ complex and costly technology due to this capital constraint that we have already mentioned.

Consider for example a small cottage palm oil mill located in a rural area in Nigeria. The oil mill will consist of a small drum used as boiler and a manually operated screw press that extracts the oil from the oil palm. Production will be slow and difficult for the rural workers in the mill.

But if you compare the small rural based palm oil mill with a modern palm oil mill like Ada Palm oil mill at Ohaji in Imo State, you will realize a lot of differences. The Ada Palm oil mill is automated and employs modern technology in extracting palm oil.

## **A Practical Business Idea for Class Discussion Investing In an Exercise Book Making Plant**

Exercise books are found in all homes and also in many offices in Nigeria. Students in Nursery, Primary, Secondary Schools, Polytechnics and Universities all use exercise books. Available data suggests that there are about 23 million students in the Nigerian educational system in 1998 and this is expected to grow with time. If we add demand for exercise books coming from organizations and public institutions, it is estimated that

annual exercise book demand in Nigeria lies in the region of about 1.5 billion pieces. Supply of exercise books used to be dominated by “Apex” and “Onward” but entry into this business by local investors has broken the monopoly of “Apex” and “Onward”.

### **Technical Information**

The plant highlighted in this write up is a small scale exercise book plant that can be located anywhere in Nigeria and for which minimal space is required. Working on a single shift of 8 hours per day, an output of 4,000 exercise books is assured. Working on 3 shifts per day, total daily output is 12,000 pieces of various sizes, 2A, 40 leaves, 60 leaves, 80 leaves, higher education etc. However, this write up assumes 2 shifts of 8 hours each daily and 300 working days per annum, Core equipment required include High speed electric motor driven ruling machines, guillotine, Long arm staplers, jogging trays etc. All equipment's are available locally (local and imported models). The key raw materials – bond paper (17 x 27) is available locally and in abundant quantities.

The production process is relatively simple. The back cover of the exercise book is made using plates. The inside of the exercise book is bond paper which is ruled according to the exercise book to be made. After ruling, the papers are counted, folded and stitched. Trimming is done by the guillotine after which packaging for the market is arranged.

### **SELF ASSESSMENT EXERCISE 1**

Using your immediate environment as a guide, list five small businesses that can be started with a capital of N20, 000, 00 (Twenty thousand naira only).

#### **3.2.3 Types of Small Business**

So far we have succeeded in defining small business and also looked at the criteria that distinguish them from big business. We will go further to examine the types of small business. By business types in this context, we mean their various groupings in the economy. This grouping is based on their activities.

#### **Trading and Commerce Enterprises**

Trading is one of the commonest business activities in Nigeria today. A trader buys goods from A and sells the same goods to B at a much higher price. The difference between the purchase price and the selling price constitutes the profit of the trader. If you look around your environment you will see small businesses selling items like:

- bread
- recharge cards
- soft drinks
- sachet water

The trading and commerce group of small businesses possibly constitute over 80% of the total number of small business.

### **Service enterprises**

Service enterprises constitute another group of small business operators. Service enterprises do not necessarily sell goods to people or organizations. Rather they provide services. They provide the services that are needed by members of the larger community. Examples of service enterprises include:

- barber shops
- shoe shiners
- shoe repair shops
- hair dressing salons
- dentist shops
- a dancing theatre
- a nursery and primary school
- a HIV counseling centre
- an automobile car service workshop
- a photographer shop.

A major reason why there are many service based enterprises in Nigeria is the nature of services that they provide. For example a hair dresser may not be able to dress more than 12 hairs a day. In the circumstances when there are more than 12 hairs to dress, a new hair dresser may open shop in the same environment to take advantage of growing demand. Also a medical clinic may have the highest number of patients it can handle in a day. If the number of patients requiring medical attention increases, it is an indication that a new medical clinic should open in the same area.

### **Small Manufacturing Enterprises**

Small manufacturing enterprises are another major and important group in the Nigerian economic landscape. They engage in basic manufacturing activities that do not involve complex technologies or huge capital outlays.

Examples of small manufacturing enterprises include:

- sachet water manufacturing enterprises
- bread baking enterprises
- laundry soap making enterprises
- nylon blowing enterprises
- exercise book making enterprises

### **SELF ASSESSMENT EXERCISE 2**

In discussing the types of small business, we identified three main types of small business enterprises. List the three types of small business.

### **3.3 Role of Management (Strategic Management) in a Business Decision**

Strategic management is defined as the set of decisions and actions taken in formulation and implementation of strategies designed to achieve objectives of an organisation. It involves attention to no less than nine areas as shown below.

- i. Determining the mission of the company including broad statement about its purpose, philosophy, and goals.
- ii. Developing a company profile that reflects internal conditions and capabilities.
- iii. Assessment of the company's external environment, in terms of competitive and general contextual factors.
- iv. Analysis of possible options uncovered in the matching of the company's profile with the external environment.
- v. Identifying the desired options uncovered when possibilities are considered in the light of the company mission.
- vi. Strategic choice of a set of long-term objectives and the strategies needed to achieve the desired options.
- vii. Development of annual objectives and short-term strategies combined with long-term objectives and grand strategies.
- viii. Implementing strategic choice decisions based on budgeted resource allocations and emphasizing the matching of tasks, people, strategies, technologies, and reward systems.
- ix. Review and evaluation of the success of the strategic process as a basis for control and as an input for future decision making.

As these nine areas indicate; strategic management involves the planning, directing, organizing, and control of the strategy-related decisions and actions of a business. By strategy, managers make their large-scale oriented plans for interacting with the competitive environment to ensure achievement of organisation objectives. Thus, a strategy represents a firm's "game plans." Although it does not precisely detail all future deployments, it does provide a framework for managerial decisions. A strategy reflects a company's awareness of how to compete against whom, when, where, and for what.

### **3.3.1 Dimensions of Strategic Decisions**

What decisions facing a business are strategic and therefore deserve strategic management attention? Typically, strategic issues have six identifiable dimensions, as shown below.

- i. Strategic issues require top-management decisions. Strategic decisions overarch several areas of a firm's operations. Therefore, top-management involvement in decision making is imperative. Only at this level is there the perspective for understanding and anticipating broad implications and ramifications, and the power to authorize the resource allocations necessary for implementation.
- ii. Strategic issues involve the allocation of large amounts of company resources. Strategic decisions, characteristically, involve substantial resource deployment. The

people, physical assets, or moneys needed must be either redirected from internal sources or secured from outside the firm. In either case, strategic decisions commit a firm to a stream of actions over an extended period, thus involving substantial resources.

iii. Strategic issues are likely to have a significant impact on the long-term prosperity of the firm. Strategic decisions, ostensibly, commit the firm for a long period of time, typically for five years; however, the time frame of impact is often much longer. Once a firm has committed itself to a strategic option in a major way, its competitive image and advantages are usually tied to that strategy. Firms become known in certain markets, for certain products, with certain characteristics. To shift from these markets, products, or technologies by adopting a radically different strategy would jeopardize previous progress. Thus, strategic decisions have enduring effects on the firm - for better or worse.

iv. Strategic issues are future oriented. Strategic decisions are based on what managers anticipate or forecast rather than on what they know. Emphasis is on developing projections that will enable the firm to select the most promising strategic options. In the turbulent and competitive free enterprises environment, a successful firm must take a proactive (anticipatory) stance towards change.

v. Strategic issues usually have major multi-functional or multi-consequences. A strategic decision is coordinative. Decisions include factors as customer mix, competitive emphasis, or organisational units. This necessarily involves a number of a firm's Strategic Business Units (SBUs), segmentations, divisions, or programme units. Each of these areas will be affected by allocation or reallocation of responsibilities and resources related to the decision.

vi. Strategic issues necessitate considering factors in the external environment. All business firms exist in an open system and are impacted by external conditions largely beyond their control. Thus, if a firm is to succeed in positioning itself in future competitive world, its strategic managers must look beyond the limits of the firm's ownership. They must consider what other relevant factors (e.g., competitors, customers, creditors, government, and labour) are likely to do.

### **3.3.2 Levels of Strategy**

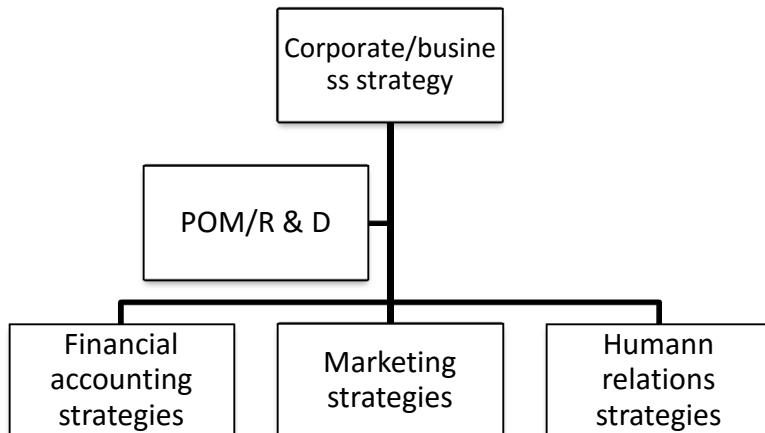
The decision-making hierarchy of business firms typically contains three levels, as shown below.

i. At the top is the corporate level, composed principally of management, board of directors and the chief executive and administrative managers. They are responsible for the financial performance of the corporation and for achieving the non-financial goals of the firm; for example, image and social responsibility. To a large extent, orientations and level reflect the concern of stakeholders and society at large.

ii. The second rung of the decision-making hierarchy is composed, principally, of business and corporate managers. This must translate the general statements of direction and intention of the corporate level into concrete, functional objectives and strategies of individual business divisions or SBUs. Business-level strategies must determine the basis on which a company can compete in product-market arena. While so doing, they strive to identify most profitable and promising market segment.

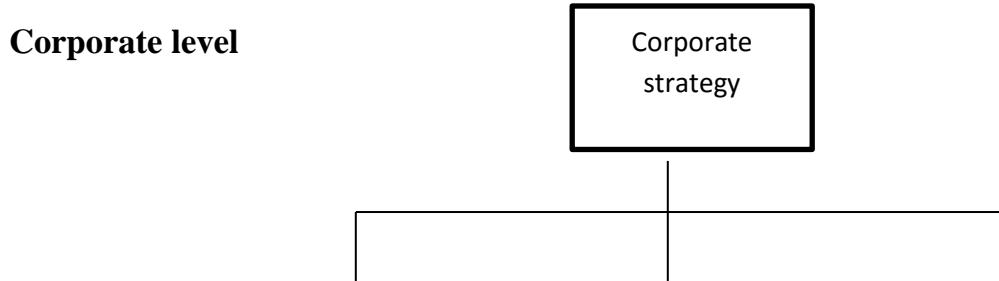
iii. The third rung is the functional level, composed principally of product, geographic, and functional managers. It is their responsibility to develop annual objectives and short-term strategies in such areas as production, operations, research and development, finance and accounting, marketing and human relations. However, their greatest responsibilities are in the implementation or execution of a company's strategic plans. While corporate and business-level managers centre their planning concerns on "doing the right things", managers at the functional level must stress "doing things right". Thus, they directly address such issues as the efficiency and effectiveness of production and marketing systems, the quality and extent of customer service, and the success of products and services in increasing their market shares.

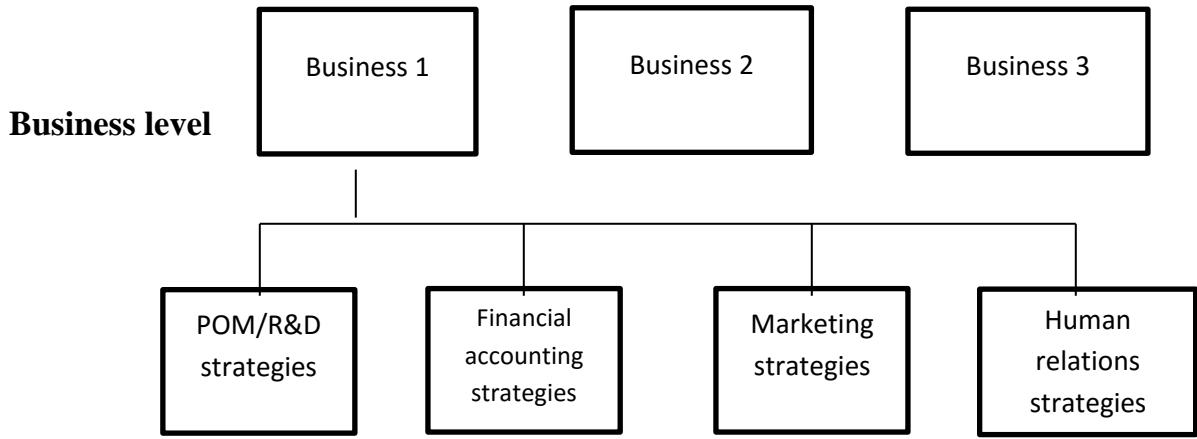
### **Alternative 1- Single-business firms**



### **Functional level**

### **Alternative 2- Multiple-business firms**





### Functional level

**Fig. 1: Alternative Strategic Management Structures**

Figure 1 depicts the three levels of strategic management as they are structured in practice. In alternative 1, the company is engaged in only one business and the corporate and business-level responsibilities are concentrated in a single group of directors, officers and managers. This structure is nearly synonymous with the organisational format of the small businesses that constitute approximately 95 percent of all business organisations in the United States.

Alternative 2 is a classical corporate structure comprised of three fully operative levels. The supra-structure is provided at the corporate level, with the super-structure at the business level giving direction and support for functional-level activities. You should note that the approach taken throughout this course is best depicted by alternative 2. Thus, whenever appropriate, topics will be covered from the perspective of each level of strategic management. In this way, this course presents one of the most comprehensive and up-to-date discussions of strategic management.

### 3.3.3 Characteristics of Strategic Management Decisions

The characteristics of strategic management decisions vary with the level of strategic activity considered. As shown in table 1, corporate-level decisions tend to be value oriented, conceptual, and less concrete than those at the business or functional level of strategy formulation and implementation. Corporate-level decisions are also characterized by greater risk, cost and profit potential, as well as by longer time horizons and greater needs for flexibility. These characteristics are logical consequences of the more far-reaching futuristic, innovative, and pervasive nature of corporate-level strategic activity. Examples of corporate-level decisions include the choice of business, dividend policies, sources of long-term financing, and priorities for growth.

At the other end of the continuum, functional-level decisions principally involve action-oriented operational issues. These decisions are made periodically and lead directly to implementation of some part of the overall strategy formulated at the corporate and business levels. Therefore, functional-level decisions are relatively short range and involve low risk and modest costs because they are dependent on available resources. Functional-level decisions usually determine actions requiring minimal company-wide cooperation. These activities supplement the functional managers' present activities and are adaptable to ongoing activities so that minimal cooperation is needed for successful implementation. Since functional-level decisions are *ENT* relatively concrete and quantifiable, they receive critical attention and analysis even though their comparative profit potential is low.

**Table 1; Characteristics of Management Decisions of Different Levels**

	Level of Strategy		
Characteristic	Corporate	Business	Functional
Type	Conceptual	Mixed	Operational
Measurability	Value judgment dominant	Semi-quantifiable	Usually quantifiable
Frequency	Periodic or sporadic	Periodic or sporadic	Periodic
Adaptability	Low	Medium	High
Relation to present activities	Innovative	Mixed	Supplementary
Risk	Wide range	Moderate	Low
Profit potential	Large	Medium	Small
Cost	Major	Medium	Modest
Time horizon	Long range	Medium range	Short range
Flexibility	High	Medium	Low
Cooperation required	Considerable	Moderate	Little

Some common functional-level decisions include generic versus brand-name labeling, basic versus applied R&D, high versus low inventory levels, general versus specific-purpose production equipment, and close versus loose supervision. Bridging corporate and functional-level decisions are those made at the business level. As table 1 indicates, business-level descriptions of strategic decisions fall between those for the other two levels. For example, business-level decisions are less costly, risky, and potentially profitable than corporate-level decisions, but they are more costly, risky, and potentially profitable than functional-level decisions. Some common business-level decisions involve plant location, marketing segmentation and geographic coverage, and distribution channels.

The strategic management approach emphasizes interaction by managers at all levels of the organisational hierarchy in planning and implementation. As a result, strategic management has certain behavioural consequences that are also characteristic of

participative decision making. Therefore, an accurate assessment of the impact of strategy formulation on organisational performance also requires a set of non-financial evaluation criteria – measures of behavioural-based effects. In fact, it can be argued that the manager trained to promote the positive aspects of these behavioural consequences is also well positioned to meet the financial expectations of the firm. However, regardless of the eventual profitability of strategic plans, several behavioural effects can be expected to improve the welfare of the firm.

1. Strategy formulation activities should enhance the problem prevention capabilities of the firm. Because of encouraging and rewarding subordinate attention to planning considerations, managers are aided in their monitoring and forecasting responsibilities by workers who are alerted to needs of strategic planning.
2. Group-based strategic decisions are most likely to reflect the best available alternatives. Better decisions are probable outcomes of the process for two reasons. First, generating alternative strategies is facilitated by group interaction; second, screening of options is improved because group members offer forecasts based on their specialized perspectives.
3. Employee motivation should improve as employees better appreciate the productivity-reward relationships inherent in every strategic plan. When employees or their representatives participate in the strategy formulation process, a better understanding of the priorities and operations of the organisation's reward system is achieved, thus adding incentives for goal-directed behaviour.
4. Gaps and overlaps in activities among diverse individuals and groups should be reduced as participation in strategy formulation leads to a clarification of role differentiations. The group meeting format, which is characteristic of the delineations of individual and subgroup responsibilities.
5. Resistance to change should be reduced. The required participation helps eliminate the uncertainty associated with change, which is at the root of most resistance. While participants may no more be pleased with their own choices, than they would stick to authoritarian decisions and their acceptance of new plans is more likely if employees are aware of the parameters that limit the available options.

## **4.0 Conclusion**

In this unit, we discussed the nature and concept of management and small business. We also discussed the role of management (strategic management) in business decisions.

## **5.0 Summary**

- Weihrich and Koontz say that management as a process is designing and maintaining an environment in which individuals, working together in groups, efficiently accomplish selected aims.
- It is not easy to define small business. This is because the definition presents conceptual problems. The problems arise because different people see small business from different binoculars. The small urban hair dresser is a small business operator viewed from any viewpoint.
- Strategic management is defined as the set of decisions and actions taken in formulation and implementation of strategies designed to achieve objectives of an organisation.

## **6.0 Tutor-Marked Assignment**

- i. State the characteristics of management decisions at different levels

## **7.0 References/Further Reading**

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## **UNIT 2 ~~CHARACTERISTICS AND BUSINESS GOALS OF SMALL BUSINESS ENTERPRISES~~**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Characteristics of Small Business
  - 3.2 Ownership
  - 3.3 Size of employees
    - 3.3.1 Revenue and Profitability
    - 3.3.2 Market Area
    - 3.3.3 Location
    - 3.3.4 Limited Investment
  - 3.4 Goals of Small Business
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor Marked Assessment
- 7.0 References/Further Reading

### **1.0 INTRODUCTION**

In the previous unit, we discussed about the nature of small business. This unit contains information related to the characteristics of small business as well as the goals of small business.

### **2.0 OBJECTIVES**

At the end of this unit, you will be able to:

- explain the major characteristics of small business
- define the goals of small business

### **3.0 MAIN CONTENT**

#### **3.1 Characteristics of Small Business**

The characteristics of a small business vary from one place to another but there are few similar characters related to a small business. The following are few characters of a small business:

#### **3.2 Ownership**

Small businesses mostly prefer to be organized as sole proprietorship, partnership or limited liability companies.

### **3.3 Size of Employees**

Small scale businesses employ smaller teams of employees than companies that operate on a larger scale because most small businesses are labor-intensive. The smallest businesses are run entirely by single individuals or small teams.

#### **3.3.1 Revenue and Profitability**

Small scale business revenue is generally lower than companies that operate on a large scale. Note that lower revenue does not necessarily translate into lower profitability. Established small businesses often own their facilities and equipment outright, in which, in addition to other factors, helps to keep costs lower than more leveraged businesses.

#### **3.3.2 Market Area**

Small scale business serves a much smaller area than corporations or large businesses. A small convenience store might serve a single community and due to its size, it cannot serve areas much larger than a local area, since growing beyond that would increase the scale of the business operation and push it into a new classification.

#### **3.3.3 Location**

A small scale business is mostly found in a limited area, along busy streets or major mode of transport. Also, the business is often located closer to material and supply sources and to markets, easing the burdens of transportation and time.

#### **3.3.4 Limited Investment**

In a small business enterprise, capital is supplied by an individual or a small group of individuals.

### **3.4 Goals of Small Business**

Setting of goals is of great importance to a business, as it helps the growth of the business. Small business begins in almost as many ways as there are entrepreneurs. Some are started by people who are out of work or unhappy where they are working. Some are started on a part-time basis to bring in extra income for the owner. Still others are begun for the sheer challenge or creativity involved. Some of these part-time operations never grow beyond their simple beginnings.

Owners may be content with small-scale operations and not want to get any bigger. Other businesses grow into full-time larger companies, sometimes becoming partnerships or corporation.

Other small businesses are started by people who've developed a product or service that can be produced and sold only in a new business set up for that purpose. Historically, many such businesses have evolved into large corporations, providing employment opportunities for many other people.

The following are goals a small business owner must achieve;

- **Profitability**

A common business goal is to run a profitable operation which typically means increasing revenue while limiting expenses. To reach this goal, objectives could consist of increasing annual sales by 10%.

- **Efficiency**

Efficiency in a business operation is a way to increase productivity. To improve efficiency, you might decide to get raw materials earlier than you normally do to satisfy your consumers.

- **Growth**

Most small business does not aim at growth at all thereby offering existing product, process and service. Growth should be the goal of any small business.

## **4.0 CONCLUSION**

Characteristics of small businesses are used to identify a small business while the goals are driving forces of a business. Every business owner must strive for growth.

## **5.0 SUMMARY**

In this unit, we discussed the various characteristics of small businesses. Also goals of a small business enterprise were discussed in this unit.

In the next unit, we shall discuss the need for small business enterprises.

## **6.0 TUTOR MARKED ASSIGNMENT**

1. List the various characteristics of a small business?

2. How does efficiency relate to productivity?

## **7.0 REFERENCES AND FURTHER READING**

Lawal, K.A.A and Oludimu, (2011) Management Principles, Practice and Focus: Asogun Books, Ibadan

Oyedijo, A., Oladele, J. and Olumoko, Y. (2008) Entrepreneurship and Small Business. Strategic-international press ltd, Lagos.

## **UNIT 3 NEED FOR SMALL BUSINESS ENTERPRISES**

### **CONTENTS**

1.0 Introduction

- 2.0 Objectives
- 3.0 Main Content
  - 3.1 General Importance of Small Business Enterprises
  - 3.2 Importance of Small Business Enterprises in the Economic Development
  - 3.3 Problems of Small Business Enterprises
    - 3.3.1 Inadequacy of Finance
    - 3.3.2 Lack of Continuity
    - 3.3.3 Poor Implantation of Government Policy
    - 3.3.4 Poor managerial skills
    - 3.3.5 Inadequate information base
    - 3.3.6 Inadequate Infrastructure
    - 3.3.7 Lack of adequate raw materials
    - 3.3.8 Poor accounting system
    - 3.3.9 Unstable policy environment
- 4.0 Conclusion
- 5.0 Summary
- 6.0 Tutor Marked Assessment
- 7.0 References/Further Reading

## **1.0 INTRODUCTION**

In the previous unit, we discussed about the characteristics and goals of small business. In this unit, we will be talking about the need for small business enterprises.

## **2.0 OBJECTIVES**

At the end of this unit, you will be able to:

- explain the importance of small business
- explain the problems of small business

## **3.0 MAIN CONTENT**

### **3.1 General Importance of Small Business Enterprises**

The importance of small business enterprises cannot be overlooked and they include:

- It provides employment opportunities
- Helps to conserve foreign exchange
- Promotes indigenous entrepreneurial skills
- Enhances the quality of life in urban and rural areas

- Reduces rural/urban migration
- Responds promptly to the dynamic business environment than big businesses
- Helps in production of special and varied products and services which may not be attractive business options to large firms.
- Facilitates the use of untapped savings thereby encouraging capital formation which is the engine of growth.

### **3.2 Importance of Small Business Enterprises in the Economic Development**

Small business enterprise account for substantial part of the total industrial employment, production and value added in an economy business concern.

- It act as catalyst for technological development
- Provides employment opportunities
- They provide training ground for establishment and management of a large firm, over time some of these firms grow in size either by expansion or by merging with other firms.
- They encourage and promote private sector initiatives and development.
- They help to fill the gap left and un-serviced by the large firms.
- They help to tap the relatively ignored and other unexploited resources and areas of production
- They said the process of redistribution of incomes in many countries both in pure financial terms and in regional terms.
- They act as industrial links between local producers of raw materials and industrial concerns
- They have positive implications for improving the standard of living of the citizens and generation of foreign exchange through export.

### **3.3 Problems of Small Business Enterprises**

Even though small business enterprise has its importance, it is necessary to look at the problems facing small business enterprises. These problems include;

#### **3.3.1 Inadequacy of finance capital**

Majority have limited access to diverse sources of capital or even foreign exchange as institutional credit.

#### **3.3.2 Lack of continuity**

Most small business enterprises are sole proprietorship and ceased to exist as soon as the owner loses interest or he is dead.

### **3.3.3 Poor Implantation of Government Policy**

So many government policies in respect of small business enterprises are poorly implemented, which makes it possible to continually sustain and support small business enterprises.

### **3.3.4 Poor Managerial Skills**

Most owners do not have the required skills to successfully run the organization. More importantly there are no avenues for training to improve their skills.

### **3.3.5 Inadequate Information Base**

Small business enterprises are characterized by poor record keeping and there are no institutional support facilities for them to have access to required information for effective planning and management purposes.

### **3.3.6 Inadequate Infrastructure**

Facilities that are needed as support base to start, run a business successfully and to grow are grossly inadequate. In some cases these facilities have to be provided by the owners of the enterprises.

### **3.3.7 Lack of Raw Materials**

In some cases, needed raw materials are sourced externally. Hence the fate of such establishment is tied to the availability of foreign exchange, fluctuation in the exchange rate and strict government policy for accessing the foreign exchange.

### **3.3.8 Poor Accounting System**

Most small scale enterprises do not keep proper records and in some cases none is kept. It is therefore difficult to assess and evaluate their viability and package them for external credit facilities.

### **3.3.9 Unstable Policy Environment**

Constant changes in government policy destabilize or lead some small business enterprises folding up. Some of these policies are not only contradictory sometimes they are outrightly discouraging.

## **4.0 CONCLUSION**

The importance of small business enterprises are extensive but the problems of small business enterprises cannot be overlooked as it shows the area where business owners and the government work on in order have more successful enterprises.

## **5.0 SUMMARY**

In this unit, we discussed the importance of small business enterprises and their importance on the economic development of where they are located. We also discussed the problems of small business enterprises.

## **6.0 TUTOR MARKED ASSIGNMENT**

1. List 5 ways small business enterprises can influence the economic development of a place?
2. What are the problems facing small business enterprises?

## **7.0 REFERENCES AND FURTHER READING**

Belbin, R.M. (1996). Management Teams: Why they succeed or fail, Oxford Butterworth – Heineman (New paperback edition).

Mbadiwe Ukaegbu (2005). Small business and entrepreneurship management. Nile Ventures, Lagos. pp 8 and 54-55.

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## **UNIT 4 BASIC CONCEPTS IN MANAGEMENT**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Basic Concept of management
- 4.0 Conclusion

- 5.0 Summary
- 6.0 Tutor Marked Assessment
- 7.0 References/Further Reading

## **1.0 INTRODUCTION**

In the previous unit, we discussed about the need for small business enterprises. In this unit, we will be talking about basic concepts of management and the functions of management.

## **2.0 OBJECTIVES**

At the end of this unit, you will be able to:

- define management
- explain the basic concept of management

## **3.0 MAIN CONTENT**

### **3.1 Basic Concepts of Management**

Management is a universally acceptable and necessary concept irrespective of whether or not an organization exists to make profit. It takes place at all levels in an organization and every manager performs essentially the same function whether he belongs to top or middle or first line management. The difference lies in the magnitude of the task and the scope and degree of the authority.

Lawal (1993) noted that the word Management was derived from an Italian word "managgiare" meaning to train horses. It was originally used to indicate the process of managing, training, or directing sporting and housekeeping activities. Later it was extended to the operations of government and business. Management can thus be defined as a process by which scarce resources are combined to 'achieve given objectives. This describes an activity which can be better referred to as managing. It refers to the people who carry out the activities, that is, the managers.

Put differently, Management is the achievement of organizational goals through people and other resources. The manager's job is to combine and coordinate human, material and technical resources in the best way to achieve these goals. Managers may not be directly involved in production; they do not produce a finished good, rather they direct the efforts and activities of others to achieving the organization's set goals. Management, indeed, is the critical ingredient in the six Ms' (Manpower, Machinery, Money, Market, Methods and materials,) these are the basic resources of any organization centered on the

manufacturing processes as it is widely known today. Most production efforts especially that of consumer goods, was undertaken in the home.

According to Fredrick Winslow Taylor, "Scientific management means knowing exactly what you want men to do and seeing that they do it in the best and the cheapest way."

According to Harlow Person, "Scientific management characterizes that form of organization and procedure in purposive collective effort which rests on principles or laws derived by the process of scientific investigation and analysis, instead of tradition or on policies determined empirically and casually by the process of trial and error."

According to Jones, "Scientific management is a body of rules, together with their appropriate expression in physical and administrative mechanism and specialized executives, to be operated in coordination as a system for the achievement of a new strictness in the control and process of production."

The term Management can often be used to mean a discipline, or an activity or in reference to corporate leadership. When used to mean a corporate leadership the term refers to a body or group of people who assumes joint responsibility of formulating, interpreting and implementing the broad objectives and/or policies of an organization.

The American Institute of Management defines management, "it is used to designate either a group of functions or the personnel who carry them out; to describe either an organization's official hierarchy or the activities of men who compose it; to provide antonym to either labor or ownership".

Mary Parker Follett (1868-1933), who wrote on the topic in the early twentieth century, defined management as "the art of getting things done through people". She also described management as philosophy.

One can also think of management functionally, as the action of measuring a quantity on a regular basis and of adjusting some initial plan; or as the actions taken to reach one's intended goal. This applies even in situations where planning does not take place. From this perspective, Frenchman Henri Fayol (1919) considered management as: to forecast and plan, to command and organize and to co-ordinate and control.

Frenchman considers management to consist of seven functions:

1. Planning
2. Organizing
3. Leading
4. Coordinating
5. Controlling

6. Staffing
7. Motivating.

The above are to attain organizational goals and objectives.

Brech (1963) defines management. "A social process entailing responsibility for the effective and economic planning and regulation of the operations of an enterprise, in fulfillment of a given purpose or task".

Koontz and Donnell (1968) defined management as an operational process based on the analysis of managerial functions which includes planning, organizing staffing, directing, leading and controlling.

Drucker (1973) defined management as an objective function that ought to be grounded in the responsibility for performance.

Lawrence Appley (1981) in his book titled "Management in Action" defined management as the Art of getting things done through people.

Stoner and Wankel (1988) described management as the process of planning, organizing, leading and controlling the efforts of organization members and of using all other organizational resources to achieve stated organizational goals.

Sekaran (1989) defined management as the functional process of accomplishing the goals of the organization through the help of others.

Sherlekar (2001) defines management as a social process, involving co-ordination of human and material resources, through the function of planning, organizing, staffing, leading and controlling in order to accomplish stated objectives.

Massie defines management as "the process by which cooperative group directs actions toward uncommon goals. This process involves techniques by which a distinguishable group of people (managers) coordinates activities of other people; managers seldom actually perform the activities themselves". This definition buttresses that of Hicks and Follet above.

The definitions are endless; while some corroborates themselves; other are contrary to one another. What appears to be indisputable is the fact that management is a process by which responsible people (managers) in an organization get things done through the effort of other people in grouped activities.

The size of an organization or number of employees does not determine who a manager is. Right from the very simple organization up till the more complex organization.

In short management has three distinct and different uses dimensions which are:

- Management as a process
- Special field of study (Profession)
- Organizational Positions (Managers).

## **4.0 CONCLUSION**

Management as an activity or set of activities refers to the act, or the manner in which the affairs of an organization is conducted such that the organizational goal or objectives is achieved. In effect, management is the basic integrating process of organizational activities that characterize our daily lives. The need for management arises because of the need of resources needed to satisfy the innumerable human wants coupled with the growing diversity and complexity of human activities.

## **5.0 SUMMARY**

In this unit, we discussed the basic concept of management and we looked at the various definition of management. We also defined management from a functional perspective as including the process of planning, organization, controlling, reporting and budgeting in addition to the implicit function of coordinating.

## **6.0 TUTOR MARKED ASSIGNMENT**

1. Define management?
2. What are the 3 distinct dimension of management?

## **7.0 REFERENCES AND FURTHER READING**

Belbin, R.M. (1996). Management Teams: Why they succeed or fail, Oxford Butterworth – Heineman (New paperback edition).

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## **UNIT 5        MANAGEMENT PRINCIPLES**

### **CONTENTS**

- 1.0    Introduction
- 2.0    Objectives
- 3.0    Main Content
  - 3.1    Management Principles
  - 3.2    Universal Principles in Management
  - 3.3    Why Principles in Management are useful
- 4.0    Conclusion

- 5.0 Summary
- 6.0 Tutor Marked Assessment
- 7.0 Further Reading/References

## **1.0 INTRODUCTION**

In the previous unit, we discussed about basic concepts of management and the functions of management. In this unit, we will be talking about management principles.

## **2.0 OBJECTIVES**

At the end of this unit, you will be able to:

- define management principle
- explain the usefulness of management principles

## **3.0 MAIN CONTENT**

### **3.1 Management Principles**

Principles in management are fundamental truths (or what thoughts to be truths at a given time), explaining relationship between two or more sets of variables usually an independent variable and a dependent variable. Management principles may be described as how one variable relate to another — what will happen when these variables interact. For example, in management, the principle of unity of command states that the more often an individual reports to a single superior, the more likely it is that the individual will feel a sense of loyalty and obligation and the less the likely it is that there will be confusion about instruction.

### **3.2 Universal Principles of Management**

The universal principle of management has been highlighted by Henry Fayol known as fourteen (14) principles of management these are as follow:

1. Authority and Responsibility; In order to get things done, management has the authority to give orders to the employees. With this authority comes responsibility. The accompanying power or authority gives the management the right to give orders to the subordinates. That responsibility can be traced back from performance and it is necessary to make agreements about this. Authority and responsibility essentially go hand in hand.

2. Centralization; this implies the concentration of decision making authority at the top management. Sharing of authorities for the decision-making process with lower levels (middle and lower management), is referred to as decentralization.
3. Discipline; It is often a part of the core values of a mission and vision in the form of good conduct and respectful interactions. This management principle is essential and is seen as the oil to make the engine of an organization run smoothly.
4. Division of work; Employees are usually specialized in different areas and have different skill sets. The levels of expertise can be differentiated within knowledge areas. As such, Fayol stated that Specialization promotes efficiency of the workforce and increases productivity.
5. Equity; This occurs in the core values of an organization. Employees must be treated kindly and equally. They also must be in the right place in the organization to do things right. Managers should supervise and monitor this process and they should treat employees fairly and impartially.
6. Esprit de corps; this stands for striving for the involvement and unity of the employees. Managers are responsible for the development of morale in the workplace, individually and in the area of communication. Esprit de corps contributes to the development of the culture and creates an atmosphere of mutual trust and understanding.
7. Initiative; Fayol argued that with this management principle employees should be allowed to express new ideas. This encourages interest, involvement and creates added value for the company. Employee initiatives are a source of strength for the organization. This encourages the employees to be involved and interested.
8. Order; This principle states that employees in an organization must have the right resources at their disposal so that they can function properly in an organization. In addition to social order the work environment must be safe, clean and tidy.
9. Remuneration; motivation and productivity are close to one another in terms of the smooth operation of an organization are concerned. Remuneration should be sufficient to keep employees motivated and productive. There are two types of remuneration namely non-monetary (a compliment, more responsibilities, credits) and monetary (compensation, bonuses etc.).
10. Scalar chain; this is basically the hierarchy in an organization. The principle states that there should be a clear line in the area of authority. This can be seen as type of management structure. Each employee can contact a manager or a superior in an emergency situation without challenging the hierarchy.
11. Subordination of Individual Interest; there are different kinds of interest in an organization. In order for an organization to function well, Fayol indicated that personal interests are subordinate to the interests of the organization. The main focus is on the organizational objectives and not on those of the individual.
12. Stability of tenure; this principle represents deployment and managing of personnel and this should be in balance with the service that is provided from the organization. Management strives to minimize employee turnover and to have the

right staff in the right place. Focus areas such as frequent change of position and sufficient development must be managed well.

13. Unity of Command; This means that an individual employee should receive orders from one manager and that the employee is answerable to that manager. If tasks and related responsibilities are given to the employee by more than one manager, this may lead to confusion which may lead to possible conflicts for employees. This principle essentially brings about accountability.
14. Unity of direction; this principle is all about focus and unity. All employees deliver the same activities that can be linked to the same objectives. All activities must be carried out by one group that forms a team. These activities must be described in a plan of action. The manager is responsible for this plan and he/she monitors the progress of the defined and planned activities.

Nevertheless, Fayol's contribution to management theory is unique and valuable. He identified six activities that must be accomplished in all industrial organizations. These are:

1. Accounting
2. Commercial
3. Financial
4. Managerial
5. Technical and
6. Security

Fayol held that the importance of managerial ability increases managerial skill as the most important component of job performance.

### **3.3 Why Principles in Management are Useful**

The following are reasons for the usefulness of principles in management;

1. To increase efficiency.
2. To give a definite and concrete shape to management.
3. To improve research in management.
4. To attain social goals by increase efficiency in the use of research.

## **4.0 CONCLUSION**

In designing an effective organization structure, for example, a number of principles are interrelated and have a predictive value for manager. Some principles give guidelines for delegating authority; this includes the principle of delegating by results expected, the principle of equality of authority and responsibility, the principle of unity of command.

## **5.0 SUMMARY**

In this unit, we discussed the various management principles and why the principles of management are useful.

## **6.0 TUTOR MARKED ASSIGNMENT**

1. Define management principle?
2. Why are management principles useful?

## **7.0 REFERENCES/FURTHER READINGS**

Belbin, R.M. (1996). Management Teams: Why they succeed or fail, Oxford Butterworth – Heineman (New paperback edition).

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## **UNIT 6: MAREKTING STRATEGY AND PLANNING**

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3.2 Concept of Marketing Strategy

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## **1.0 Introduction**

In this unit, we are going to discuss the concept of marketing strategy and define Planning. We will also discuss the importance of planning, the types of planning, principles of planning, the planning process and how to evaluate it and the elements of planning

## **2.0 Objective**

At the end of this unit, students would be able to;

- Understand the concept of Marketing Strategy
- Define Planning
- Know the importance of planning
- Identify the types of plans
- Understand the principles of planning
- Explain the dimensions of strategic planning
- Know the planning process and how to evaluate it

## **3.0 Main Content**

### **3.1 Role of Marketing in a Small Business**

Marketing's role is that it communicates a consistent message to the ideal customer. Discovers what customers want and need as well as what price they will pay. Knows where to find customers that will most likely buy. Builds foundation for sales through multiple channels. In short, marketing creates the sale opportunity.

### **3.2 Concept of Marketing Strategy**

Marketing Strategy is an organization's strategy that combines all its marketing goals into one comprehensive plan. A good marketing strategy should be drawn from market research and focus on the right product mix to achieve the maximum profit potential and sustain the business. The marketing strategy is the foundation of a marketing plan.

Marketing strategy has the fundamental goal of increasing sales and achieving a sustainable competitive advantage. It includes all basic, short-term, and long-term activities in the field of marketing that deal with analysis of the strategic initial situation of a company and the formulation, evaluation and selection of market-oriented strategies that contribute to the goals of the company and its marketing objectives.

### **3.3 Marketing Management versus marketing strategy.**

The distinctions between 'strategic' and 'managerial' marketing is used to distinguish 'two phases having different goals based on different conceptual tools. Strategic marketing concerns the choice of policies aiming at improving the competitive position of the firm, taking account of challenges and opportunities proposed by the competitive environment. On the other hand, managerial marketing is focused on the implementation of specific targets.

### **3.4 Definition of Planning**

Planning is the management function of anticipating the future and determining the best course of action to achieve an organization's objectives within a given circumstance and with available human and material resources. It incorporates decisions about the activates of the organization and how they should be performed, while putting in proper shapes the resources to be used in accomplishing the set objectives. It thus answers the question of what should be done, by whom, where, when and how. Although, planning may not mean automatic success of an organization, as organizations that plan may still fail because of other variables or factors that are attached and go together to determine such success; but, planning certainly aids the success of a business.

Put differently, planning is an organized foresight that includes corrective hind sight and guarantees the realization of an organization's objectives. It means to decide in advance, what is to be done. It is the opposite of improvising. The planning process starts with the assumption that the future will be different from the present, and therefore attempts to determine how the organization can take advantage of that difference. It is a device for change to meet future challenges.

It is however important to mention that business planning occurs in various stages and each sub-plan must be well coordinated. If the various parts of business seem uncoordinated, jumbled and haphazard in the way they function, it may reflect a lack of planning. Financial plans must be key in with raw material purchasing and payroll dates. Personal plans must relate to production schedules so that there is neither too much nor too little labour available. Production plans or schedules must be in line with sales, special promotions and market conditions.

Businesses plan because they wish to achieve certain specific goals, and realizing the implications of not planning at all or inadequate planning, it ensures the provision of a framework for coordination among functions and sub-units. Not planning may mean failure.

### **3.5 Importance of Planning**

Planning helps to define the purpose and activities of an organization. It enables performance standard to be set and results can be evaluated to compare the expected with actual

It provides the framework against which the process of control is based by serving as a veritable management tool that ensures the realization of an organization's goals.

Planning provides the premise for good and effective decision making by knowing the goals of an organization and how best to achieve them, which ensures the acceptance of the best course of action.

It is expected that planning is flexible in order to cope with the changing business environment borne out of stiffer competition and ever changing technology. By this, it assists organizations in coping with environmental dynamics.

More attention is paid to planning at the level of top management, as they set the goals, formulate policies and outline strategies for long-range purposes.

### **3.6 Types of Plan**

This is concerned with the planning horizon of a business, which is usually a function of the purpose for which a plan is made. Simply put, it answers the questions of how far into the future should a business plan. The following types are identified;

- a. Long-range plans; these are fundamental plans to the basic goals and objectives of the organization. They are plans that can be used in determining the nature of products, markets, locations, capacities etc. such plans usually extend beyond one year, although they provide the basis for shorter-range plans.
- b. Medium-range plans; this includes plans that pay attention to such things as seasonal variations in sales of product, production in relation to demand, particularly where such sales is seasonal. Medium range plan is considered within one month or one year, and ought to be developed within the framework of the long-range plans.
- c. Short-range plans; they are made to implement goals that emanates from medium-range plans. They are plans that involve daily operations and hence, ranges between one-day and one-month e.g schedules for labour, machines, materials flow etc. it ensures the required lead time between planning and execution.

The other types of planning include;

- Strategic plans; it is a statement that outline an organization's mission and future direction, exposing the performance targets and means or strategies in which the organization's goals will be accomplished taken into cognizance the strengths, weaknesses, opportunities and threats that the organization is confronted with.
- Operational plans; it reflects the extent to which strategies plan are implemented daily and ensures the realization of the set objectives. It is handled by the middle and lower level officers or managers.
- Tactical plans; this is hard-core of the organization's plan that formulate policies and determine the strategies to be adopted to ensure the success of an organization. It is the responsibility of top management, considered to be the 'think-tank' of the business.

### **3.7 Principles of Planning**

- i. Plans should be based upon clearly defined objectives using available information optimally.
- ii. It should take into consideration environmental factors as the environment makes or mares the success of the business.
- iii. It should consider the existing organizations and provide for control, so that performance can be checked against establishing standard.
- iv. It has be precise, realizable and simple to understand and operate.
- v. It must be flexible and accommodate change whenever the need arise.

### 3.8 Planning process

Planning is said to be the essence of management yet there is no formula for planning. Business people have attempted so much while striving to get effective process of planning. The following are identified steps of the planning process;

1. **Self-Audit;** it presupposes knowing where a business is now. An assessment of the present status of the business is required to know where it should be in the future. An objective analysis devoid of bias is important and must be ensured at this point. This is because a plan provides a spring board from the present. The planner should start considering the conditions that affect the company's future opportunity. These conditions include; the environment, internal conditions, and obligations of the enterprise. It is equally important that a self-audit, that is meaningful enough will determine the status of the following factors; financial position, condition of facilities and equipment, quantity and quality of workforce, appropriateness of organizational structure, major policies and strategies, competitive position, and profitability of product lines.
2. **Survey environment;** the business organization exists in three kinds of environment; through the total economy, in an industry, and in a specific geographical area. If the organization is able to make its own independent appraisal of the total economy, it will want to consider a broad range of business indicators. The more important parameters are industrial production, wholesale prices, retail prices, employment and unemployment, personal incomes, sales and inventories, merchandise exports and imports, availability of credit, raw material prices, new incorporations, business failures, gross national product, corporate profits and central budget.
3. **Objectives or Goal Formulation;** it is an important aspect of planning process as it poses to be the bedrock of the ideals which the organization stands for. It is the review and comprehensive of the organization's mission and the translation of mission into concrete terms. One value in scanning the environment is to uncover available opportunities. The objectives selected may be of various types. They might involve increased market share, penetration of new geographic areas or product lines, profitability goals, development of new technologies, or cost reduction programs. Forecasts, therefore, is major input to the process of setting objectives.
4. **Resource Requirements and Budgets;** the formulation of goals determines the strategies to be adopted in achieving results and provides the basis for organizational resources requirements. It is expected that forecasts and objectives

are converted into actual resource requirements, that must include labour, material, space equipment, etc. for effectiveness, budgets must be taken into cognizance as they are important expression of business plans.

5. **Plan Outputs;** A plan output is expected to be financially sound, and must be communicated to people in the company that is to implement it. The efficacy of a plan lies in its implementation. The plan output may be in several possible forms; statements of objectives, policies, rules and procedures and budgets.
6. **Use of control in planning;** planning must go beyond implementation as the implemented plans ought be measured against set objectives and control mechanism must be available and be reviewed periodically to determine progress.

### **3.9 .Evaluation of Planning Process**

The evaluation of planning process is premised on its output. People must make the process work, and this is only possible when the process is well understood. The following must be considered;

- a. Statements of Objectives; it is important that those who are to implement the plans understand the targets or goals of the organization so as not to be working at cross-purposes. As the overall organization management must set goals, so also must each department, section or division. In fact, business is better managed today by objectives.
- b. Strategies and policies; policy-making is important, so also is strategies in the process of planning. Policies are general statements that serve as guides for the actions of managers. They are indeed guidelines for actions which help subordinates to carry on their work in harmony with the overall business objectives.
- c. Procedure and rules; procedures are more specific with respect to what to do. They reduce the judgement a person may use in solving a problem. They are more restrictive than policies but reflect a planned approach. They are rigid, as they leave little or no room for use of discretion. Rules on the other hand are specific instructions in regard to what may not be done. They are more restrictive than procedures.
- d. Budgets; budget us the process of setting planned activities while considering the future. It is expressed in financial and quantitative terms, stating the financial implications of an organization's plans.

### **3.10 Elements of Planning**

The following are important elements that ought to be incorporated in an comprehensive planning activity set out to achieve the desired results;

- Organization planning
- Financial planning
- Operational planning
- Product planning
- Human resource planning
- Facility planning
- Production planning
- Material supply and inventory planning
- Commercial planning
- Development planning

#### **4.0. Conclusion**

At the end of this unit, we were able to discuss the importance of planning, the types of planning, principles of planning, the planning process and how to evaluate it and the elements of planning.

#### **5.0. Summary**

- Planning helps to define the purpose and activities of an organization. It enables performance standard to be set and results can be evaluated to compare the expected with actual
- It provides the framework against which the process of control is based by serving as a veritable management tool that ensures the realization of an organization's goals.
- Planning process; Self Audit, Survey environment, Objectives/Goal Formulation, Resources requirements and budgets, Plan Outputs and Use of control in planning.
- Types of plan; Long-range plans, Medium-range plans and Short-range plans.

#### **6.0.Tutor-marked Assignment**

- a. State the five elements of Planning
- b. Identify and Explain three types of plans.

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## **MODULE 2**

Unit 7; Strategic marketing Planning Process

Unit 8; Market Analysis

Unit 9; Marketing Mix; Pricing Policies and Strategies

Unit 10; Marketing Mix; Product

Unit 11; Marketing Mix; Channels of Distribution

Unit 12; Marketing Mix; Promotion

## **UNIT 7. STRATEGIC MARKETING PLANNING PROCESS CONTENT**

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3.0 Main Content

    3.1 The Strategic Marketing Planning Process

        3.1.1 Situation Analysis

        3.1.2 Marketing Objectives

        3.1.3 Positioning and Differential Advantage

        3.1.4 Target Market and Market Demand

        3.1.5 Marketing Mix

    3.2 Annual Marketing Planning

        3.2.1 Purposes and Responsibilities of an Annual Marketing Plan

        3.2.2 Contents of an Annual Marketing Plan

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 Further Reading

### **1.0 INTRODUCTION**

In this unit, we are going to discuss the strategic marketing planning process; that is the situation analysis, marketing objectives, positioning and differential advantage, target market and market demand and the marketing mix. We will also discuss the annual marketing plan; the purpose and responsibility of an annual marketing plan and contents of an annual marketing plan.

### **2.0 OBJECTIVES**

At the end of this unit, students will be able to;

- Understand and explain the strategic marketing planning process
- Develop, discuss and know the purpose, content and responsibilities of the annual marketing plan.

### **3.0 MAIN CONTENT**

#### **3.1 THE STRATEGIC MARKETINGPLANNINGPROCESS**

Strategic marketing planning is a five-step process that assesses current performance; establishes specific marketing objectives; determines positioning and differential advantage; selects target markets and measures market demand, and designs strategic marketing mix. With the plans in place, the marketing programmes are implemented, while the results are monitored. If the Plans work well, the feedback provides the good news. However, if the marketing programme does not meet expectations, the feedback

mechanism helps marketers adjust the processes. You should realize that strategic marketing planning is a controlling process, not a one-time event. Therefore, continuous monitoring and feedback is the surest way to stay in touch with dynamic market conditions.

Let us briefly examine what the term "strategy" means before proceeding to explore the various steps in the strategic planning process. Of course, there are various definitions of strategy. For instance, the Advanced Learners' Dictionary gives two of such;

- (i) "the art of planning operations in away, especially of the movements of armies and navies into favourable positions for fighting"
- (ii) "skill in managing any affair"

We will however adopt the definition used by aerospace and service conglomerate TRW (Bovee and Thill, 1992). This definition is simple and quite insightful: your strategy defines where and how you plan to compete. With this definition therefore, having a strategy means that you have analysed your environment, set some goals, and then made decisions about deploying the various resources at your disposal. Apart from the elements of the marketing mix, a business strategy also encompasses product research and development, manufacturing methods, financial investments, and personnel management. You will need to keep these factors in mind as we explore the marketing planning process.

We have already noted that strategic marketing planning is a five-step process as listed below:

- (i)Conduct a situation analysis.
- (ii)Develop marketing objectives.
- (iii)Determine positioning and differential advantage.
- (iv)Select target markets and measure market demand.
- (v)Design a strategic marketing mix

Let us carefully discuss each as their steps:

### **3.1.1 SITUATION ANALYSIS**

Situation analysis is the first step in a strategic marketing planning. It usually involves analysis where the company's marketing programme has been, how it has been performing and what is likely to face in the years ahead. This step allows management to determine the necessity of revising the old plans or devise new ones to realize the company's objectives.

Situation analysis normally covers external environmental forces and internal marketing resources (e.g. R& D. capabilities, finances, and skills together with the experience levels

of personnel) surrounding the marketing programme. In addition, situation analysis considers the groups of consumers served by the company, the strategy adopted to satisfy them, and key measures of marketing performance.

From the foregoing, you would see that as a basis for planning decisions, situation analysis is quite critical. You would also agree that it can be very costly, time-consuming, and at times, frustrating. For example, it is usually difficult to extract timely, accurate information from the huge pile of data accumulated during a situation analysis. Furthermore, some valuable information, such as sales or market-share figures for competition, is often not available.

In continuation of a situation analysis, many marketers often combine several stages of examination in a technique called SWOT analysis, from an acronym of strengths, weaknesses, opportunities, and threats. Once they have analysed both themselves and their competitors using SWOT analysis, they have a good idea of what their strategic objectives should be, as well as what their competitors' objectives might be. The application of SWOT analysis to competitors is part of a larger effort known as competitor intelligence, which is a systematic process of understanding competitions and their influence on your markets.

### **3.1.2 MARKETING OBJECTIVES**

This is the second step in strategic marketing planning. Very often, marketing goals should be closely related to companywide goals and strategies. A company strategy usually translates into a marketing goal. For example, to reach an organizational objective of a 25 percent return on investment next year, one company strategy might be to reduce marketing costs by 20 percent. Thus, this company strategy could become a marketing goal.

Earlier on, you were made to understand that strategic management involves matching an organisation's resources with its market opportunities. In this regard therefore, each objective should be assigned a priority based on its urgency and potential impact on the marketing area, and, in turn, the organization. These priorities should be the basis for allocating the company's resource. Generally, it is recommended that each objective should

be SMART, an acronym for Specific, Measurable, Attainable, Realistic, and Time-bound.

### **3.1.3 POSITIONING AND DIFFERENTIAL ADVANTAGE**

Two complementary decisions are involved in the third step of strategic marketing planning: how to position a product in the market place, and how to distinguish it from competitors. These will be discussed in detail under product-mix strategies. The process

of achieving a desired position in the mind of the market is called positioning. For instance, you can position your company, your products, your technologies, or any other entity that commands customer attention. After the product is positioned, a viable differential advantage should be identified. Here, differential advantage refers to any features of an organization or brand perceived by

### **3.1.4 TARGETMARKET AND MARKET DEMAND**

The fourth step in strategic marketing planning is the selection of target markets. We have already defined a market as consisting of people or organizations with needs to satisfy, money to spend, and the willingness to spend it. This market may be large, and usually consist of several segments (i.e parts of markets) with differential needs. Ordinarily, it might be impossible for a firm to satisfy all segments with different needs. It is therefore better for a company to target its efforts on one or more of these segments. Hence, a target market refers to a group of people or organizations at which a firm directs a marketing programme. Details of target markets are described under market segmentation and target-market strategies.

In a new firm, it is necessary for management to analyse markets in detail to identify potential target markets. Regarding an existing firm, management should routinely examine any changes in the characteristic of its target markets and alternative markets. Consequently, management should decide to what extent and in what manner to divide up total markets and then pursue only those segments that are more promising for successful marketing.

It has been suggested that target markets must be selected based on opportunities. In order to analyse these opportunities, a firm needs to forecast demand or sales in its target markets. The results of such demand forecasting will indicate whether the firm's targets are worth pursuing, or whether alternatives need to be identified.

### **3.1.5 MARKETINGMIX**

The last step in the strategic marketing planning process is the design of an appropriate marketing mix, i.e. the combination of product, price, promotion and distribution (place). These four elements should collectively satisfy the needs of the organisation's target markets and, at the same time achieving marketing objectives.

We shall briefly examine the four elements together with some of the concepts as well as relevant strategies applicable to each: Details are covered in latter units

(i)Product: Strategies are needed for managing existing product over time, adding new ones, and dropping failed products. Strategic decisions must also be made regarding branding, packaging, quality levels, design, and other product features such as warranty, after-sales service etc.

(ii)Price: Here, the necessary strategies relate to the locations of customers, price flexibility, related items within a product line, and terms of sales. In addition, pricing strategies for entering a market, especially with a new product, must be designed.

(iii)Distribution: The relevant consideration with respect to distribution involve the management of the channel(s) by which ownership of products is transferred from producer to customer and, in many cases, the system(s) by which goods are moved from where they are produced to where they are purchased by the final customer. Consequently, the necessary strategies applicable to middlemen (wholesalers and retailers) must be designed.

(iv)Promotion: Coordinated campaign strategies are needed to blend individual promotion methods such as advertising, personal selling, sales promotion and publicity. Furthermore, it is necessary to adjust promotional strategies as a product moves from the early stages to the later stages of its Hein summary, if the analysis of a potential market is promising enough to make it a good target, management should develop a marketing mix that will appeal to this market. For example, it should assemble a combination of product characteristics that closely matches what the customers in the target market are looking for. Next, it should create a structure of prices that will make product purchase feasible for market members. Furthermore, management should put together a distribution system that assures goods are made available where and when they are wanted. Finally, it is necessary for management to assemble a promotional mix of advertising and other tools that will communicate the benefits of the offer to the target market.

### **3.2 ANNUAL MARKETING PLANNING**

Apart from the basic strategic planning spanning several years into the future, it is also necessary to develop a more specific, and shorter—term marketing plan. Hence, strategic marketing planning in an organization leads to the preparation of an annual marketing plan. Annual marketing plan is the master blueprint for a year's marketing activity for a specified organizational division or major product. It is usually a written document.

#### **3.2.1 PURPOSES AND RESPONSIBILITIES OF AN ANNUAL MARKETING PLAN**

An annual marketing plan serves at least three purposes:

- (i) It summarizes the marketing strategies and tactics that will be used to achieve specified objectives in the upcoming year. Thus, it serves as a "how-to-do-it" document that guides executives and other employees involved in marketing.
- (ii) The plan also points to what needs to be done with respect to the other steps in the management process, such as implementation and evaluation of the marketing programme.
- (iii) The annual market plan also outlines who is responsible for which activities, when they are expected to be carried out, and how much time and money can be spent. Very often, the executive responsible for the division or product covered by the plan typically is he task to subordinates.

### **3.2.2 CONTENTS OF AN ANNUAL MARKETING PLAN**

The following are the contents of an annual marketing plan:

(i) Executive Summary and Table of Contents:

The marketing plan usually opens with a summary of the main goals of the plan and recommendations. The executive summary permits senior management to grasp the plan's major thrust. A table of contents follows the executive summary.

(ii) Current marketing situation:

This section presents relevant background data on sales, costs, profits, the markets, competitors, distribution, and the macro environment. The data are drawn from a product fact book maintained by the product manager.

(iii) Opportunity and issue analysis:

After summarizing the current marketing situation, the product manager goes ahead to identify the major opportunities/threats, strengths and weaknesses, as well as issues facing the product line.

(iv) Objectives:

With the summary of the issues given, the product manager must decide on the plan's financial and marketing objectives.

(v) Marketing strategy:

In this section, the product manager outlines the broad marketing strategy or "game plan" to accomplish the marketing plan's objectives. In developing the strategy, the product manager often discusses with the purchasing and production personnel to confirm that they will be able to buy enough materials and produce enough units to meet the target sales volume levels. In addition, the product manager needs to discuss with the sales manager to obtain sufficient sales force support. Furthermore, he should discuss with the accountant to obtain sufficient funds for advertising and promotion.

(vi) Action programmes:

The marketing plan must specify the broad marketing programme for achieving the business objectives. Each marketing strategy element must be elaborated to answer such questions as: what will be done? When will it be done? Who will do it? How much will it cost?

(vii) Projected profit-and —loss statement:

This section usually includes two kinds of financial information :On the revenue side, this budget shows forecasted sales volume in units and the average price. On the expense side, it shows the cost of production, physical distribution, and marketing, broken down into finer categories. The difference between these two sides is the projected profit. With its approval, the budget is the basis for developing plans and schedules for material procurement, production scheduling, employee recruitment, and marketing operations.

(viii) Controls:

The last section of the marketing plan outlines the controls for monitoring the plan. Typically, the goals and budget are spelled out for each month or quarter. The results for each period are reviewed by senior management. Some control sections often include contingency plans, which outline the appropriate steps to be taken by management with respect to specific adverse developments, such as price wars or strikes.

## **4.0 CONCLUSION**

You have learned in this unit that, a company that wants to compete successfully in the marketplace must show sufficient commitment to creating and retaining satisfied customers. The company must also know how to adapt to a continually changing marketplace.

## **5.0 SUMMARY**

Market—oriented strategic planning is the managerial process of developing and maintaining a viable fit between the organisation's objectives, skills and resources, and its

changing market opportunities. The main goal of strategic planning is to help a company select and organize its businesses in a way that will keep the company healthy even when unexpected events adversely affect any of its specific businesses or product lines.

#### **6.0 TUTOR - MARKED ASSIGNMENT Question:**

- a. What are the purposes of an annual marketing plan?
- b. List the contents of an annual marketing plan.

#### **7.0 FURTHER READING**

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### **UNIT 8; MARKET ANALYSIS CONTENTS**

1.0 Introduction

2.0 Objectives

3.0 Main Content

    3.1 The Marketing Environment

    3.2 The Micro Environment

    3.3 The Market Environment

    3.4 The Macro Environment

    3.5 Determining the Strengths and Weaknesses of Opportunities for and Threats to the Enterprise (SWOT Analysis)

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

## 7.0 References/Further Readings

### 1.0 Introduction

In this unit, we will be discussing the marketing environment, the composition and functioning of the marketing environment, the micro and macro environment and methods of analyzing the market environment.

### 2.0 OBJECTIVES

After studying this unit, you should be able to:

- Explain the marketing environment
- Explain micro-environmental variables
- Explain macro-environmental variables
- Differentiate between opportunities and threats
- Explain the implications of these variables to marketing companies.

### 3.0 MAIN CONTENT

#### 3.1 The Marketing Environment

The marketing environment consists of three components, also called sub-environments, which are known as the micro-environment, market environment, and macro-environment. Each of these sub-environments consists of variables which can influence an enterprise, its workers and

their families. In the market environment, for example, competition may have a very negative influence on the enterprise, lowering the profitability of the enterprise and impacting negatively on wage negotiations with the labour force. This is but one instance of how a variable beyond the control of an enterprise can influence the running of the enterprise.

#### 3.2 The Micro-Environment

The micro-environment of an enterprise refers to all the activities that are executed by that enterprise. An enterprise must perform diverse activities in order to function properly and to attain the profit objectives that have been decided on. To put this into a clearer perspective, let us

look at the Hajia Amina Florist Shop in Balogun Market, Lagos. Hajiya Amina employs two permanent flower arrangers as well as a delivery person. Her rent per month is N3,000.00. She must pay N600.00 per month on the delivery vehicle that she has leased. The flowers that she

buys from the market must be paid for in cash. Within these limitations of the micro environment, Hajiya Amina must fulfill her commitments and still earn enough to make a living for herself and her two children! This example illustrates the influence of the micro-environment on the enterprise and shows that she can control most of the activities which are part of the micro-environment (e.g. she may decide to employ less staff or to move to cheaper premises). These variables in the microenvironment must all be managed by Hajiya Amina to ensure success. These variables are also known as controllable variables. These variables in the micro-environment are discussed below:

- a. **The Product;** Managing the product entails planning and developing the right products and/or services to be marketed by the company's executives. Guidelines are needed for changing existing products, adding new ones, and taking other actions that affect the assortment of products carried. Branding, packaging and various other product features need to be considered as well.
- b. **Price;** Determining the right base price for its (company's) products is one of the crucial micro-variable factors to be considered by the enterprise. Also, establishing policies concerning discounts, freight payments, and many other price related variables form part of the management responsibility to ensure that the enterprise objectives are attained.
- c. **Promotion;** Promotion entails those weapons used to inform and persuade the markets, regarding a company's products. These include advertising, personal selling, publicity and sales promotion.
- d. **Distribution/Place;** This is the management of the marketing intermediaries for the distribution of the company's products. Management's responsibility is to select and manage the trade channels through which the products will reach the right target markets at the right time and to develop a distribution system for physical handling and transporting of these goods. Note, the management or marketing executives can manipulate these variables to meet their company's objectives. For example, the product features can be changed, prices can be increased or reduced depending on the market situation, the most appropriate promotional media can be chosen, etc.

### 3.3 The Market Environment

The key variables in the market environment are:

- consumers
- competitors
- intermediaries
- suppliers

These variables will influence the enterprise, which makes it imperative for management to react to opportunities and threats in the market environment.

Consumers are the people buying your enterprise's products and services. Identifying the target market for your product or service is therefore one of the most important management activities to be undertaken by management.

Competitors are a natural part of a capitalistic society. We are accustomed to the fact that various competitors compete for our money in the case of most products and services. The example of Toyota and the competitive environment in which it operates illustrates this point.

Intermediaries; Intermediaries such as wholesalers and retailers evolved to bridge the gap between the manufacturer and the supplier. New developments in this field constitute opportunities for, or threats to, certain enterprises operating in this industry. One such example is the development of convenience shops at petrol filling stations and the resultant threat to the traditional convenience stores, such as cafes, in Nigeria.

Suppliers: An enterprise is dependent on suppliers to run its business. One such example of a supplier is the supplier of capital to an enterprise. Traditionally, the commercial banks are the suppliers of capital to small and medium businesses. Listed companies such as Nigerian Bottling

Company, makers of Coca cola have an additional supply of capital provided by their shareholders.

### **3.4 The Macro-Environment**

It is important to realise that the enterprise operates within a wider macro-environment, in which variables directly or indirectly influence the enterprise and its market environment. The enterprise cannot always control these variables and they must be continually evaluated to ensure that potential opportunities or threats are correctly identified. The increase in the world crude oil price during Iraq's aggressive expansionist period in the early nineties (i.e. during the Gulf War) is an example of the influence of a macro-variable on business in general and more specifically on the ordinary citizens of a country. (Remember the drastic increase in the price of petrol in Nigeria.)

The following six macro-variables in the macro-environment may either individually, or together, affect the enterprise at any time:

- the technological environment
- the economic environment
- the social environment
- the natural or physical environment
- the institutional/political environment

- the international environment

You should have identified six variables which may affect Hajiya Amina Enterprises in different ways. Let us examine them now!

- The Technological Environment: This environment is affected by innovation and change. For example, new manufacturing processes and new technology may influence the type and quality of clothing being sold by wholesalers and retailers in Nigeria. One needs only to think of the new types of material available, such as those combining natural and synthetic fibers to create crease-resistant material.
- The Economic Environment: This variable is well known to everyone. An increase in the inflation rate, changes in the exchange rate and a higher rate of personal income tax are examples of how the economic environment may influence wholesales and retails in Nigeria.
- The Social Environment: Social changes are prevalent throughout the world and Nigeria. A decline in the population growth rate may eventually have a negative impact on sales of trendy imported clothing in the affected market. The changing role of women in society (e.g. more women in full-time position and more career women as experienced in this democratic dispensation) may be a positive variable in the case of Hajiya Amina Enterprises, and may result in a higher turnover. To add to the complexity of the task facing marketing executives, cultural patterns such as lifestyles, beliefs, norms, values, folkways etc. are changing faster than they used to; therefore, management must be alert to them.
- The Natural or Physical Environment: This variable is of great concern to people all over the world. Scarce resources for example are utilized in the packaging of clothing and wastage of packaging material must be of concern to Hajiya Amina Enterprises, for example.
- The Political/Governmental, also called Institutional Environment: This variable in the macro-environment would be of concern to Hajiya Amina Enterprises. One example of the effect of this variable would be surcharges on imported clothing. This would have a direct influence on the selling price of the clothing sold by Hajiya Amina Enterprises in Nigeria. Other variables include general and fiscal policies.
- The International Environment: As was said at the beginning of this topic, Nigeria is part of the global village. As such, our economy and its businesses are directly influenced by economic development in the Far Eastern countries, for example. In

the case of Hajiya Amina Enterprises, it may benefit from a better exchange rate, enabling Mr. Audu Giya to import his clothing at a cheaper price.

By now you should have realized that the macro-environment is an active force which influences each enterprise operating in Nigeria and which no business, whether big or small, can ignore. Since it cannot be controlled, but influenced to the company's advantage, then management should be alert to changes in the macro-environment.

### **3.5 Determining the Strengths and Weaknesses of Opportunities for and Threats to the Enterprise (SWOT Analysis)**

In order to ensure the success of an enterprise, the management must take a careful look at the marketing environment. This can be done by means of a SWOT analysis. This means that the enterprise's strengths and weaknesses must be identified, as well as the opportunities and threats that exist in the environment.

Strengths may include specialized management skills, a productive and well-trained workforce, enough capital, and so on.

Weaknesses within the microenvironment may include an obsolete product range, unacceptable levels of pilferage and lack of capital. Lack of capital is one of the major problems experienced by small and medium enterprises (SMEs) in Nigeria. One of the greatest strengths of SMEs is their management adaptability to a changing business environment. Hawkers selling groceries in the major towns and cities of Nigeria can adapt to changes in consumer demand almost immediately, whereas the village seller for example, would take longer to do so.

Opportunities for the enterprise can be found in the market and macro environment. For instance, look around you and you will see that there has literally been an explosion of fast-food businesses in Nigeria. It would therefore seem that quite several budding entrepreneurs in Nigeria have identified opportunities in this sector.

Threats are also found in the market and macro-environment. For example, a drastic fall in the Naira/dollar exchange rate is a threat to importers of luxury goods such as cars. At the same time, such a decline may be seen as an opportunity for exporters of Nigerian products to African countries, European Union and the USA. (They will be able to obtain a higher price in naira for their products.)

#### **3.5.1 SWOT Analysis**

Executing a SWOT analysis is a must for any enterprise that wants to be successful in the business world. The following Self Assessment Exercise will help to familiarize you with the elements of the SWOT analysis.

### **SELF ASSESSMENT EXERCISE**

You are the owner of Fati's Pizza Shop in Umuahia in Abia State of Nigeria. Your business has been operating for the past four years and made a handsome profit, in the first three years. However, the current year's sales figures are bad with a 20 percent decline in turnover. Yesterday evening you listened to the news at seven and heard about the following major developments in the economy:

- i. A decline in the inflation rate of 2 percent for the year.
- ii. A decrease in the interest rate of 2 percent for the past year.
- iii. An increase in unemployment of 5 percent, with specific reference to the high level of unemployment in the country.
- iv. A growth in fast-food enterprises of 20 percent over the last year.
- v. A decline in the per capita personal disposable income of 10 percent during the last year.
- vi. New legislation whereby more females must be employed in the existing workforce.

After listening to this news you spent the whole night thinking about it and the implications for your business. This morning you phoned the nearest branch of the Small Business Development Corporation (SBDC) for advice. The consultant advised you to do a SWOT analysis of your business. Draw up a list of its strengths and weaknesses, and current opportunities and threats.

### **4.0 CONCLUSION**

In this unit, you have learnt about the micro and macro-environmental variables and their implications for marketing firms.

### **5.0 SUMMARY**

An enterprise functions within certain marketing environmental variables. These variables are known as controllable and uncontrollable variables. These variables influence the activities of an enterprise. Therefore, it is the task of management to evaluate these variables and their impact on the enterprise and to recommend strategies to utilize the opportunities and counteract the threats.

### **6.0 TUTOR-MARKED ASSIGNMENT**

Why are the 4ps (promotion, price, product and price) referred to as controllable variables?

## **7.0 REFERENCES/FURTHER READINGS**

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## **UNIT 9: MARKETING MIX; PRICING POLICIES AND STRATEGIES**

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## **1.0 INTRODUCTION**

Price is an important element of the marketing mix. It can be used as a strategic marketing variable to meet competition. It is also a direct source of revenue for the firm. It must not only cover the costs but leave some margin to generate profit for the firm. However, price should not be so high as to frighten the customers. Price is also an element, which is highly perceptible to customers and significantly affects their decisions to buy a product. In general, price directly determines the quality to be sold. That is why electric fans are sold at lower prices and hotels reduce their tariffs during off-season periods to attract customers. This unit examines pricing policies and some strategies adopted by company executives.

## **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- state the factors affecting the pricing decision
- state the importance and role of cost in pricing
- identify the different methods used in pricing
- explain how pricing can be used to achieve the objectives at each stage of the products life-cycle
- state the difference in pricing of customer and industrial products
- outline how pricing can help position a product in relation to other competing products.

## **3.0 MAIN CONTENT**

### **3.1 Determinants of Pricing**

Pricing decisions are usually determined by cost, demand and competition. We shall discuss each of these factors separately. We take demand first.

- a. Demand:** The popular ‘Law of Demand’ states that “the higher the price; the lower the demand, and vice versa, other things remaining the same”. In season, due to plentiful supplies of certain, agricultural products, the prices are low and because of low price, the demand for them increases substantially. You can test the validity of this law yourself in your daily life. There is an inverse relationship between price and quantity demanded. If price rises, demand falls and if the price

falls, the demand goes up. Of course, the law of demand assumes that there should be no change in the other factors influencing demand except price. If any one or more of the factors, for instance, income, the price of the substitutes, taste and preferences of the consumers, advertising, expenditures, etc. vary, the demand may rise in spite of a price rise, or alternatively, the demand may fall in spite of a fall in price. However, there are important exceptions to the law of demand.

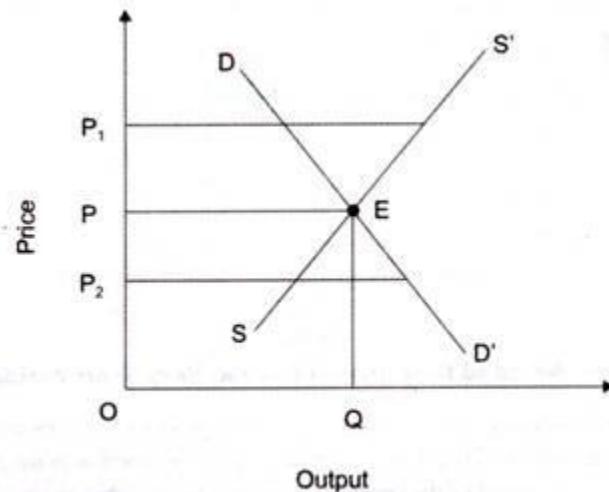
There are some goods, which are purchased mainly for their 'snob appeal'. When prices of such goods rise, their snob appeal increases and they are purchased in larger quantities; therefore, their demand falls. Diamonds provide a good example. In the speculative market, a rise in price is frequently followed by larger purchases and a fall in prices by smaller purchases. This is especially applicable to purchases of industrial raw materials. More important than the law of demand is the elasticity of demand. While the law of demand tells us the direction of change in demand, elasticity of demand tells us the extent of change in demand. Elasticity of demand refers to the response of demand to a change in price.

It is necessary for the marketer to know what would be the reaction of the consumers to the change he wishes to make in the price. Let us take some examples. Smokers are usually so addicted to smoking that they will not give up smoking even if prices of cigarettes increase. So also the demand for salt or for that of wheat is not likely to go down even if the prices increase. Another example of inelastic demand is the demand for technical journals, which are sold mainly to libraries. On the other hand, a reduction in the price of television will bring in more than a proportionate increase in demand. Some of the factors determining the price-elasticity of demand are the nature of the commodity, whether it is a necessity or luxury, extent of use, range of substitutes, urgency of demand and frequency of purchase of the product.

The concept of elasticity of demand becomes crucial when a marketer is thinking of lowering his price to increase the demand for his product and to get a larger market share. If the increase in sales is more than proportionate to the decline in price, his total sale proceeds and his profits might be higher. If the increase in sales is less than proportionate, his total sales proceeds will decline and his profits will definitely be less. Thus, knowledge of the elasticity of demand for his products will help a marketer to determine whether and to what extent he can cut the price or pass on the increase in cost to the consumer. It may also be noted that the price elasticity of demand for a certain

commodity and the price elasticity of demand for a certain brand of that commodity may be radically different. For example, while cigarettes as such, may be highly inelastic, the price elasticity of demand for 'Capstan' or 'Charms' may be highly elastic. The reasons for these are weak brand loyalty and the availability of substitutes.

b. **Competition;** The degree of control over prices, which the sellers may exercise, varies widely with the competitive situation in which they operate. Sellers operating under conditions of pure competition do not have any control over the prices they receive. A monopolist, on the other hand, may have some pricing discretion. The marketer; therefore, needs to know the degree of pricing discretion enjoyed by him. Let us take up each of these cases individually.



**Figure-3: Price and Output Determination under Perfect Competition**

DD = Demand Curve

SS = Supply Curve

E = Point of Equilibrium

In **pure competition**, all that the individual seller can do is to accept the price prevailing in the market i.e. he is in the position of a price taker. If he wants to charge a higher price, buyers will purchase from other sellers. And he need not charge less since he can sell his small supply at the going market price.

Under a **monopoly**, a single producer has complete control of the entire supply of a certain product. Railways and telephones are examples of monopoly. The main features of a monopoly are (i) there is only one seller of a particular good or service and (ii) rivalry from the producers of substitutes is so remote that it is almost insignificant. As a result, the monopolist is in a position to set the price himself. Thus, he is in the position of a price setter.

However, even in the case of a monopolist, there are limits to the extent to which he can increase his prices. Much depends on the elasticity of demand for the product. This, in turn, depends on the extent of availability of substitutes for the products. And in most cases, there is rather an infinite series of closely competing substitutes. Even railways and telephone organisations must take into account potential competition by alternative services – railways may be substituted by

motor transport and telephone calls by telegrams. The closer the substitute and greater the elasticity of the demand for a monopolist's product, the less he can raise his price without frightening away his customers. The high price of oil has led to the development of alternative sources of energy, such as solar energy. Monopolies are constantly reducing due to the following reasons:

- 1) shifts in consumer demand
- 2) continuous process of innovation and technological developments leading to development of substitutes
- 3) lack of stimulus to efficiency provided by competition
- 4) entry of new competitors Intervention by governments.

**Oligopoly** is a market situation characterized by a few sellers, each having an appreciable share in the total output of the commodity. The automobile, cement, tyre, infant food, dry batter, tractor, cigarette, aluminum and razor blade industries provide examples of oligopolies. In each of these industries, each seller knows his competitors individually in each market. Each oligopolistic realizes that any change in his price and advertising policy may lead rivals to change their policies. Hence, an individual firm must consider the possible reactions of the other firms to its own policies. In such cases, there is a strong tendency towards close collaboration in policy determination in regard to both production and prices. Thus, oligopolists follow the philosophy of 'live and let live'. Oligopolistic industries are usually characterized by what is known as price leadership – a situation where firms fix their price in a manner dependent upon the price charged by one of the firms in the industry, called the price leader. The price leader has lower costs and adequate financial resources, a substantial share of the market and a reputation for sound pricing decisions. Price leaders with the strongest position in the market may often increase their prices with the hope that competitors will follow suit. Price followers may delay raising their prices in the hope of snatching a part of the market share away from the leader.

**Monopolistic competition** is a market situation, in which there are many sellers of a particular product, but the product of each seller is in some way differentiated in the minds of consumers from the product of every other seller. None of the sellers is in a position to control a major part of the total supply of the commodity, but every seller so differentiates his/her portion of the supply from the portions sold by others, that buyers hesitate to shift their purchases from his/her product to that of another in response to price differences. At times, one manufacturer may differentiate his/her own products. For example, a blade manufacturer may manufacture more than 25 **brands** of blades. This differentiation of products by each manufacturer by giving it a brand name gives him some amount of monopoly if he is able to create goodwill for his products and he may therefore be able to charge higher prices to some extent. Still, his product will have to compete with

similar products of other manufacturers, which puts a limit on his pricing discretion. If he charges too high a price, consumers may shift their loyalty to other competing suppliers. You can find it out yourself by going to the market, to see that a large number of consumer goods like toothpaste, soap, cigarettes; radios, etc. are subject to a large degree of product differentiation as a means of attracting customers. As long as a consumer has an impression that a particular product brand is different and superior to others, he/she will be willing to pay more for that brand than for any other brand of the same commodity. The differences, real or illusory, may be built up in his or her mind by;

- (a) Recommendations by friends,
- (b) Advertising and
- (c) His own experience and observation.

The producer gains and retains his customers by;

- (a) Competitive advertising and sales promotion,
- (b) The use of brand names, quite as much as by
- (c) Price competition.

Product differentiation is more typical of the present day economic system, than either pure competition or monopoly. And, in most cases, an individual firm has to face monopolistic competition. It tries to maintain its position and promote its sales by either;

- a) changing its price and indulging in price competition, or
- b) intensifying the differentiation of its product, and /or
- c) increasing its advertisement and sales promotion efforts.

There is a popular belief that costs determine price. It is because the cost data constitute the fundamental element in the price setting process. However, their relevance to the pricing decision must neither be underestimated nor exaggerated. For setting prices, apart from costs, a number of other factors have to be taken into consideration. Demand is of equal, and in some cases of greater importance than costs. An increase in price is possible, even without any increase in costs. Very often, price determines the cost that may be incurred. The product is tailored to the requirements of the potential consumers and their capacity to pay for it. For example, radio manufacturers in India realized that if they had to capture the mass market prevailing in India, they had to price it low, which could be done only by reducing the cost – reducing the number of wave – bands in the radio. And now a single wave band radio is available at about N100.

If costs were to determine prices, why do so many companies report losses? There are marked differences in costs between one producer and another. Yet the fact remains that the prices are quite close for a somewhat similar product. This is the best evidence that costs are not the determining factor in pricing.

Price decisions cannot be based merely on cost because it is very difficult to measure costs accurately. Costs are affected by volume, and volume affected by price. The management has to assume some desired price and volume relationship for determining costs. That is why costs play even a less important role in case of new products as compared to existing products. It is not possible to determine costs without having an idea of what volumes or numbers can be sold. But, since there is no experience of volumes, costs and prices, one starts with the going market price for similar products. All this discussion does not purport to show that costs should be ignored altogether while setting prices. Costs have to be taken into consideration. In fact, in the long run, if costs are not covered, manufacturers will withdraw from the market and supply will be reduced which, in turn, may lead to higher prices. The point that needs emphasis is that cost is not the only factors in setting prices. Cost must be regarded only as an indicator of the price, which ought to be set after taking into consideration the demand, the competitive situation, and other factors.

Costs determine the profit consequences of the various pricing alternatives. Cost calculations may also help in determining whether the product, whose price is determined by its demand, is to be included in the product line or not.

### **SELF-ASSESSMENT EXERCISE**

In the example stated in Exercise 1, the cost behaviour changes levels of production as follows:

No. of units manufactured	Cost Price per unit (N)
50,000	450
45,000	470
55,000	440
60,000	430
70,000	420
100,000	400

Considering the price levels and expected sales mentioned earlier in Exercise 1, what would be the optimal price under above behaviour situation?

### **3.2 Pricing Methods**

After discussing the various considerations affecting pricing policies, it would be useful to discuss the alternative pricing methods most commonly used. These methods are:

- 1) Cost-plus or Full-cost pricing
- 2) Pricing for a rate of return, also called target pricing
- 3) Marginal cost pricing
- 4) Going rate pricing, and

## 5) Customary prices.

The first three methods are cost-oriented, as the prices are determined on the basis of costs. The last two methods are competition-oriented, as the prices here are set on the basis of what competitors are charging.

### **3.2.1 Cost-Plus or Full-Cost Pricing**

This is the most common method used in pricing. Under this method, the price is set to cover costs (materials, labour and overhead) and a predetermined percentage for profit. The percentage differs strikingly among industries, among member-firms and even among products of the same firm. This may reflect differences in competitive intensity, differences in cost base and differences in the rate of turnover and risk.

In fact, it denotes some vague notion of just profit. What determines the normal profit? Ordinarily margins charged are highly sensitive to the market situation. They may, however, tend to be inflexible in the following cases:

- 1) They may become merely a matter of common practice.
- 2) Mark-ups may be determined by trade associations either by means of advisory price lists or by actual lists of mark-ups distributed to members.
- 3) Profits sanctioned under price control as the maximum profit margins remain the same even after the price control is discontinued. These margins are considered ethical as well as reasonable. Their inadequacies are:
  - a) It ignores demand – there is no necessary relationship between cost and what people will pay for a product.
  - b) It fails to reflect the forces of competition adequately. Regardless of the margin of profit added, no profit is made unless what is produced is actually sold.
  - c) Any method of allocating overheads is arbitrary and may be unrealistic. Insofar as different prices would give rise to different sales volumes, unit costs are a function of price, and therefore, cannot provide a suitable basis for fixing prices. The situation becomes more difficult in multi-product firms.
  - d) It may be based on a concept of cost which may not be relevant for the pricing decision.

### **Explanation for the widespread use of Full-cost Pricing**

A clear explanation cannot be given for the widespread use of full-cost pricing, as firms vary greatly in size, product characteristics and product range, and face varying degrees of competition in markets for their products. However, the following points may explain its popularity:

1. Price based on full-cost looks factual and precise and may be more defensible on moral grounds than prices established by other means.

2. Firms preferring stability, use full-cost as a guide to pricing in an uncertain market where knowledge is incomplete. In cases where costs of getting information are high and the process of trial and error is costly, they use it to reduce the cost of decision-making.
3. In practice, firms are uncertain about the shape of their demand curve and about the probable response to any price change. This makes it too risky to move away from full-cost pricing.
4. Fixed costs must be covered in the long run and firms feel insecure if they are not covered in the long run either.
5. A major uncertainty in setting a price is the unknown reaction of rivals to that price. When products and production processes are similar, cost-plus pricing may offer a source of competitive stability by setting a price that is more likely to yield acceptable profit to most other members of the industry also.
6. Management tends to know more about product costs than factors which are relevant to pricing.
7. Cost-plus pricing is especially useful in the following cases:
  - a) Public utilities such as electricity supply, and transport, where the objective is to provide basic amenities to society at a price which even the poorest can afford.
  - b) Product tailoring, i.e. determining the product design when the selling price is predetermined. The selling price may be determined by government, as in the case of certain drugs, cement, and fertilizers. By working back from this price, the design and the permissible cost is decided upon. This approach takes into account the market realities by looking from the viewpoint of the buyer in terms of what he wants and what he will pay.
  - c) Pricing products that are designed to the specification of a single buyer as applicable in case of a turnkey project. The basis of pricing is estimated cost plus gross margin that the firm could have got by using facilities otherwise.
  - d) Monophony buying – where the buyers know a great deal about suppliers' costs as in the case of an automobile maker buying components from its ancillary units. They may make the products themselves if they do not like the price. The more relevant cost is the cost that the buying company, say the automobile manufacturer, would incur if it made the product itself.

### 3.2.2 Pricing for a Rate of Return

An important problem that a firm might have to face is one of adjusting the prices to changes in costs. For this, popular policies that are often followed are as:

1. Revise prices to maintain a constant percentage mark-up over costs.
2. Revise prices to maintain profits as a constant percentage of total sales.
3. Revise prices to maintain a constant return on invested capital

The use of the above policies is illustrated below:

#### ILLUSTRATION

A firm sells 100,000 units per year at a factory price of N12 per unit.

The various costs are given below:

Variable	Costs Materials	N360,000
	Labour	N420,000
Fixed	Costs Overhead	N120,000
	Selling & Administrative charges	N180,000
Total investment in cash, inventory and equipment		N800,000

Suppose the labour and materials cost increases by 10 per cent. The question is how to revise price according to the three policies discussed above.

The above data reveal that costs are N1,080,000. The profits as percentage of costs, sales and capital employed (according to the three policies are):

$$1 \text{ Percentage over Costs} \quad 120,000 \quad = 11.1$$

$$1,080,000$$

$$2 \text{ Percentage on Sales} \quad \frac{120,000}{1,200,000} \quad = 10$$

$$3 \text{ Percentage on Capital employed} \quad \frac{120,000}{800,000} \quad = 15$$

The revised costs are N1,158,000 (N1,080,000 + 36,000 + 42,000)

According to the first formula, we have to earn a profit of 11.1 per cent on costs. Our revised profits should be #128,667 and sales volume on this basis would be N1,286,667. The selling price would, therefore be N 12.87 per unit.

Under the second formula, the profit should be 10 per cent on sales. If sales are (S), the profit would be  $S/10$  and cost would be  $9S/10$ . The cost known to us and we have to find out the sales.

If  $9S/10 = N1,158,000$  then  $S = N1,286,667$ .

Therefore, the price per unit is N12.87.

Under the third formula, we assume that the capital investment is the same. Therefore, the required profit is N120, 000 (15 per cent on N800,000). The sales value would then be N1,278, 000 and the selling price per unit would be N12.78.

Rate of return pricing is a refined variant of full-cost pricing. Naturally, it has the same inadequacies, viz. it tends to ignore demand and fails to reflect competition adequately. It is based upon a concept of cost, which may not be relevant to the pricing decision in hand and overplays the precision of allocated fixed costs and capital employed.

### **3.2.3 Marginal Cost Pricing**

Under full-cost and rate-of -return pricing, prices are based on total costs comprising fixed and variable costs. Under marginal cost pricing, fixed costs are ignored and prices are determined on the basis of marginal cost. The firm uses only those costs that are directly attributable to the output of a specific product.

With marginal cost pricing, the firm seeks to fix its prices so as to maximize its total contribution to fixed costs and profit. Unless the manufacturer's products are in direct competition with each other, this objective is achieved by considering each product in isolation and fixing its price at a level, which is calculated to maximise its total contribution.

#### **Advantages**

1. With marginal cost pricing, prices are never rendered uncompetitive merely because of a higher fixed overhead structure. The firm's price will be rendered uncompetitive by higher variable costs, and these are controllable in the short run while certain fixed costs are not.
2. Marginal cost pricing permits a manufacturer to develop a far more aggressive pricing policy than does full-cost pricing. An aggressive pricing policy should lead to higher sales and possibly reduced marginal costs through increased marginal physical productivity and lower input factor prices.
3. Marginal cost pricing is more useful over the life-cycle of a product, which requires short-run marginal cost and separable fixed data relevant to each particular state of the cycle, not long run full-cost data. Marginal cost pricing is

more effective than full-cost pricing because of two characteristics of modern business:

- a. The prevalence of multi-product, multi-process and market concerns makes the absorption of fixed costs into product costs absurd. The total costs of separate products can never be estimated satisfactorily, and the optimal relationships between costs and prices will vary substantially both among different products and between markets.
- b. In many businesses, the dominant force is innovation combined with constant scientific and technological development, and the long-run situation is often highly unpredictable. There is a series of short runs. When rapid developments are taking place, fixed costs and demand conditions may change from one short run to another, and only by maximising contribution in each short run will profit be maximized in the long-range.

### **Limitations**

1. The encouragement to take on business, which makes only a small contribution to the business arises. Such business may have to be foregone because of inadequate free capacity, unless there is an expansion in organisation and facilities, with the attendant increase in fixed costs.
2. In a period of business recession, firms using marginal cost pricing may lower prices in order to maintain business and this may lead other firms to reduce their prices, leading to cut-throat competition. With the existence of idle capacity and the pressure of fixed costs, firms may successively cut down prices to a point at which no one is earning sufficient total contribution to cover its fixed costs and earn a fair return on capital employed.

In spite of its advantage, due to its inherent weakness of not ensuring the coverage of fixed costs, marginal cost pricing has usually been confined to pricing decision relating to special orders.

#### **3.2.4 Going-Rate Pricing**

Instead of the cost, the emphasis here is on the market. The firm adjusts its own price policy to the general pricing structure in the industry. Where costs are particularly difficult to measure, this may seem to be the logical first step in a rational pricing policy. Many cases of this type are situations of pricing leadership. Where price leadership is well established, charging according to what competitors are charging may be the only safe policy. It must be noted that 'going-rate pricing' is not quite the same as accepting a price impersonally set by a near perfect market. Rather it would seem that the firm has some power to set its own price and could be a price maker if it chooses to face all the consequences. It prefers, however, to take the safe course and conform to the price of others.

### 3.2.5 Customary Pricing

Prices of certain goods become more or less fixed, not by deliberate action on the seller's part but as a result of their having prevailed for a considerable period of time. With such goods, changes in costs are usually reflected in changes in quality or quantity. Costs change significantly only when the customary prices of these goods are changed. Customary prices may be maintained even when products are changed. For example, the new model of an electric fan may be priced at the same level as the discontinued model. This is usually so even in the face of lower costs. A lower price may cause an adverse reaction on the competitors leading to a price war so also on the consumers who may think that the quality of the new model is inferior. Perhaps, going with the prices as long as possible is a factor in the pricing of many products. If a change in customary prices is intended, the pricing executive must study the pricing policies and practices of competing firms and the behaviour and emotional make-up of his opposite number in those firms. Another possible way out, especially when an upward move is sought is to test the new prices in a limited market to determine the consumer reaction.

### 3.3 Objectives of Pricing Policy

Before a marketer fixes a price, he should keep in mind certain basic considerations. The pricing policy he adopts is closely related to his other policies, like production programme, advertising policy, and selling methods. For example, it may be necessary to reduce the price to offset the probable loss of sales from a lower advertising budget or to enable fuller utilisation of plant capacity more quickly. Aggressive sales campaign may be necessary to meet the advent of a new competitor. Your price should not be so high that it attracts others to compete with you. A low price may result in such a high volume of sales and low unit costs that profits are maximised even at low prices. If a marketing manager is to make effective pricing decisions, he should be clear about the firm's long-term marketing objectives for the entire range of products and services. If the firm is interested in increased market share, it would have to resort to penetration pricing. If it is interested in short-term profitability, it may have a higher price even at the expense of sales volume and market share.

The following table gives a summary of some marketing objectives and their pricing implications:

#### Some Marketing Objectives & their Pricing Implications

Marketing Area	Marketing Objectives	Pricing Implications
Product	Improve Quality Acceptance	Higher cost = Price increase or lower profit.
Advertising and Promotion	Stronger Support	Increased Advertising and Publicity budget = Price

		increase or lower profit
Distribution	Additional Selling Points	Possibly higher Distribution costs (margin increase)
Consumers/Users	General Acceptance	Increase Advertising and Publicity effort.

Source: J.J. Ward (Editor), (1985). *The Export Marketing Management*. Geneva: International Trade Centre.

### 3.4 Consumer Psychology and Pricing

Sensitivity to price change will vary from consumer to consumer. In a particular situation, the behaviour of one individual may not be the same as that of the other. Some important characteristics of the consumer as revealed by research and experience are detailed below:

1. From the point of view of the consumer, prices are quantitative and precise whereas product quality, product image, customer service, promotion and similar factors are qualitative and ambiguous. It is easier to speculate about what consumers would do if prices rose by 5 per cent than if the quality improved by 5 per cent.
2. Price constitutes a barrier to demand when it is too low just as when it is too high. Above a particular price, the article is regarded as too expensive and, below another price, as constituting a risk of not giving adequate value. If the price is too low, consumers will tend to think that a product is of inferior quality.

Balsara, manufacturers of 'Odonil' and 'Promise' realised that pricing a product too low could adversely affect its sales by creating a credibility problem. Consequently, they began to price their products with higher unit margins, to make higher advertising outlays to emphasise product attributes rather than the price and provide more attractive margins to dealers to push up their products (*Business India*, April 28-May 11, 1980, 35).

3. Price inevitably enters the consumer's assessment of quality. There are two reasons for this:

- (a) It needs expert knowledge and appropriate equipment to test the quality or durability of some particular products (to say nothing of the time and cost involved in carrying out a proper test).
- (b) Customers tend to look upon price itself as a reasonably reliable indicator of quality. What is costly is thought to be of high quality. A higher price is ordinarily taken to be a symbol of extra quality, or extra value of extra prestige. It is very difficult to convince

people that something cheap is of good quality and that something expensive is of poor quality. It may be easier to prove that an expensive product is of superior quality than to prove that a cheap product is of good quality. This is especially true of durable consumer goods which are very often differentiated, at least psychologically, through branding, packaging and advertising. In such cases, the sale of certain goods could be stimulated more effectively through higher rather than lower prices for two reasons:

- (i) The higher price increases the snob appeal of the goods.
- (ii) The higher price creates confidence in the customer that he/she is getting good quality.
- (iii) To conclude, in many cases, price is used by the prospective customer as a clue for sizing up the quality of the product. This price quality association is well established.
- (iv) With an improvement in incomes, the average consumer becomes quality-conscious. An improvement may, therefore, lead to an increase in demand. If this is so, a time may come when a rise in prices results in an increase in demand. This extreme situation may arise if price in increasingly affluent societies comes to serve merely as an indicator of quality.
- (v) Consumers may be persuaded to pay more for heavily advertised goods. A firm's size, its financial success, and even its age are often perceived by consumers as measures of quality. Well known firms very often assert that by virtue of their reputation they are able to charge 5 to 10 per cent higher than other firms but definitely not much more.
- (vi) In a comprehensive survey of consumer consciousness, it was revealed that the basic postulate of the demand theory, i.e., the consumer has an appropriate knowledge of market prices, was not fundamentally wrong.

An experimental study in Nigeria showed that more than 50 per cent of the respondents revised their ratings of ready-made shirts after knowing their prices, indicating thereby that price information does have a significant effect on quality perception.

In fact, higher prices that increase consumer readiness to buy may sound uneconomic, but may not be unrealistic. The price-quality concept has equal relevance to new product pricing. The lesson from this discussion is that the producer has considerable flexibility in pricing his products, provided he can create a psychological image of quality.

### **3.2 Nature and Use of Price Discounts**

There are two popular types of discounts:

**1. Quantity Discounts;** Quantity discounts are price reductions related to the quantities purchased. Quantity discounts may be related to the size of the order being measured in terms of physical units of a commodity. This is practicable where the commodities are homogeneous or identical in nature, or where they may be measured in terms of truck-loads. However, this method is not possible in case of heterogeneous commodities which are hard to add in terms of physical units or truckload. The drug industry and the textile industry offer examples of these types. Here, quantity discounts are based upon the money value of the quantity ordered. Money becomes a common denominator of value. Quantity discounts based on physical units become important where cost of packing is a significant factor and orders of less than standard qualities, say, less than a case of 6 pressure cookers, may involve higher packing charges per cooker since the space remains unutilized. Thus, quantity discounts may be employed to induce full carton purchasing. In some cases, quantity discounts may be based on the cumulative purchases made during a period, usually a year or a season, e.g. Christmas discounts may be given based on cumulative purchases made during the Christmas season spread over October to December. One important objective of quantity discounts is to reduce the number of small orders and thereby avoid the high cost of servicing them. Quantity discounts can facilitate economic size order in three ways:

- a. A given set of customers is encouraged to buy the same quantity but in bigger lots.
- b. The customers may be induced to give the seller a larger share of their total requirements by giving preference over competitors.
- c. Small size purchasers may be discouraged and bigger size customers may be attracted.

In many cases, discounts have become a matter for trade customers.

Quantity discounts are most useful in the marketing of materials and supplies but are rarely used for marketing equipment and components.

**2. Cash Discounts;** Cash discounts are price reductions based on promptness of payment. An example of discount can be 2 per cent off if paid in ten days, full invoice price min 30 days. In practice, the term cash discounts may vary widely. Cash discount is a convenient device to identify and overcome bad credit risks. In certain trades where credit risk is high, cash discounts would be high. If a buyer decides to purchase goods on credit, this reflects his weak bargaining position, and he has to pay a higher price by foregoing the cash discount. By prompt collections, manufacturers reduce their working capital requirements and thus save their interest costs. However, allowing discounts may involve paying 36.5 per cent in order to save 18 per cent.

On the basis of 2 per cent off if paid in 10 days, full involve price in 30 days, the seller's cost comes to 36.5 per cent (for getting the money 20 days before he has to lose 2 per cent which amounts to 36.5 per cent per year). He could get accommodation from any bank at about 18 per cent. Thus, it is the reduction in collection expenses and in risks rather than savings on interest, which should be the guiding consideration for cash discounts.

### **3.3 Product Positioning and Price**

By 'positioning' we mean the way a product is viewed by the customers in comparison with similar products. Price is just one element of the marketing mix and it must reflect the product's position in the market. A toilet soap meant to be a novelty to attract the elite must be sold at a higher price. This is the basic idea behind product differentiation, i.e. to avoid a situation where the product has to compete only on the basis of price.

Pricing is an important element of the marketing mix. Pricing is affected not only by the cost of manufacturing the product, but also by:

- (i) the company's objectives in relation to market share and sales
- (ii) the nature and intensity of competition
- (iii) stage of the product life-cycle at which the product is currently positioned
- (iv) nature of product whether as consumer or industrial product, and if the former, whether it is a luxury or necessity. Before making any pricing decision it is important to understand all these factors.

There are various methods of pricing. The four most commonly used methods are full cost pricing, pricing for rate of return, going rate pricing, and customary pricing. While the first two methods are based on the costs incurred, the latter methods are based on the competition's pricing. While from the company's point of view, price represents a kind of 'maximum' that it can charge given its own costs and nature of competition, from the costumer's viewpoint it is a representation of quality of the product.

## **4.0 CONCLUSION**

Pricing policies are considered one of the most marketing mix elements. The psychological pricing affects mainly from one consumer, to another. The importance attached to the price of a company's product by the consumer is significant to the marketing activities. Thus, in fixing a price for a product, marketing executives should consider necessary pricing policies and other market elements.

## 5.0 SUMMARY

In this unit, we examined, Pricing methods, Objectives of pricing policy, Nature and use of pricing discounts and Product positioning and price.

## 6.0 TUTOR-MARKED ASSIGNMENT

i. Let us assume that consumer behaviour in terms of units bought of this manufacturer is as follows:

Price	No. of units sold
22	50,000
21	60,000
20	70,000
23	40,000
24	30,000
25	20,000

What is the price at which the manufacturer should sell the product?

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## UNIT 10; MARKETING MIX; PRODUCT

### CONTENT

1.0 Introduction

2.0 Objectives

### 3.0 Main Content

- 3.1 What is a Product?
- 3.2 Product Levels
- 3.3 Classification of Products
- 3.4 Consumer Products
  - 3.4.1 Convenience Products
  - 3.4.2 Shopping Goods
  - 3.4.3 Specialty Goods
  - 3.4.4 Unsought Goods
- 3.5 Industrial Goods
  - 3.5.1 Installation
  - 3.5.2 Equipment, Tools and Accessories
  - 3.5.3 Raw Materials
  - 3.5.4 Semi-Processed Components and Parts
  - 3.5.5 Consumables and Operating Supplies
- 3.6 Characteristics of Industrial Products
- 3.7 Marketing Strategies for Consumer and Industrial Goods

### 4.0 Conclusion

### 5.0 Summary

### 6.0 Tutor-Marked Assignment

### 7.0 References/Further Reading

## 1.0 INTRODUCTION

Businesses are set up to produce products or goods and services. These products are sold to members of the society for money. Goods consist of items with attributes that have the ability to satisfy people's needs and wants. Goods are normally tangible items. Services are intangible items that can provide value and satisfaction and are also classified as products. This unit introduces you to various definitions of a product, classification of products and their characteristics.

## 2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define a product
- classify products into either consumer or industrial products
- explain the characteristics of industrial products.

## 3.0 MAIN CONTENT

### 3.1 What is a Product?

In order to be effective at selling or marketing, it is necessary to have a proper perspective of the meaning of a product or how it should be viewed from a marketing angle. You may like to think a little deeply on what is meant by the word 'product'. Let us understand this with the aid of an illustration – While conducting seminar for operational salesmen who had been on the field for 10 to 12 years, the salesmen were asked a question, 'What are you selling?' Different answers were received from different groups. One group answered, 'Soaps'. When asked, 'What? What did you say?' the salesmen would immediately answer back, 'soaps, soaps, soaps'. They even tried to help the seminar leader by putting forward their right hand with the first finger and the thumb holding something rectangular, thereby assisting him to visualise soap – others claimed they sold 'bulbs, drills, etc.'

A product is the key marketing mix variable on which all the other marketing mix variables revolve. It cannot be divested from other marketing mix variables because all of them contribute to form the

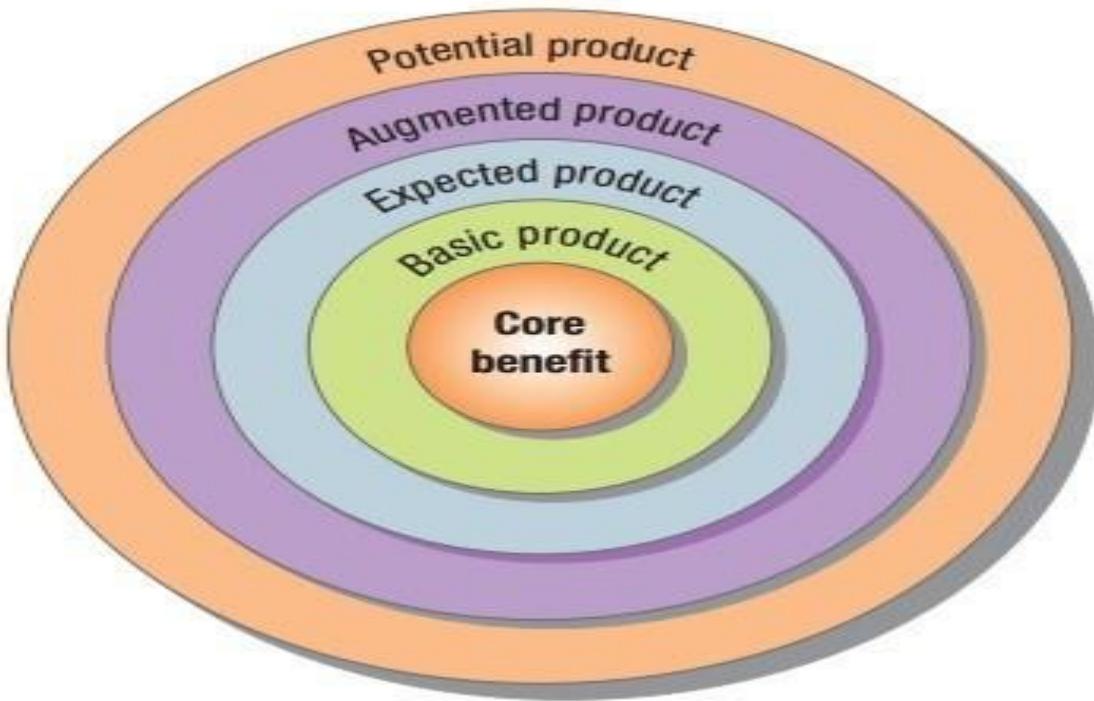
images of the product from the point of view of the buyers. These images determine the values and satisfaction expected from a given product and how much the buyers will offer for it. It is therefore important for the manufacturers and marketers to understand what a product means to consumers and their expectations from that product.

Hence, a product can be described as goods, services, ideas, people, places, and even organisations that are offered for exchange. Or, a product is the bundle of benefits or satisfaction offered to a customer. Also, a product is defined as anything offered or sold for the purpose of satisfying a need or want on both sides of the exchange process. It includes a tangible object that marketers refers to as a good, as well as an intangible service (such as ideas, a place, an event, an organisation), or any combination of tangible objects and intangible services.

However, Stanton (1981:161) defines a product as a set of tangible and intangible attributes including packaging, colour, price, manufacturer's prestige, retailer's prestige, and manufacturer's and retailer's services, which the buyer may accept as offering want-satisfaction. It should however be noted that the consumer is not interested in your goods. He/she is interested in himself or herself and what 'benefits' he/she will get, and not in you or your organisation.

### 3.2 Product Levels

This can be illustrated with the aid of a diagram as shown below:



**Source:** Kotler, P. (1987). *Principles of Marketing*

- (a) The Core Benefits:** i.e. the fundamental service or benefit that the customer is really buying. For instance, the core benefit enjoyed by a guest in a hotel is rest and sleep.
- (b) The Basic Product:** Here, marketers have to turn the core benefit into a basic product. For example, in the case of the hotel, such things as a bed, table, chair, bathroom, and dresser are the basic products enjoyed by a guest in the hotel.

**(c) The Expected Product:** Here, marketers prepare an expected product, i.e. a set of attributes and conditions buyers normally expect when they purchase a product. For example, in a hotel, guests expect a clean bed, fresh towels, constant power supply, and a relatively quiet environment.

**(d) Augment Product:** Marketers are concerned with preparing augmented products that exceed customers' expectations. For example, a hotel may have a remote controlled TV set, remote controlled air conditioner, fresh flowers, etc.

**(e) Potential Product:** This consists of all the possible augmentations and transformations the product might undergo in the future, just as we have new products in our markets daily due to modifications and diversifications undertaken by manufacturers.

### 3.3 Classification of Products

Generally, products are classified into two types namely: consumer products and industrial products.

### 3.4 Consumer Products

Consumer goods are those which are used by ultimate consumers or households and in such form that they can be used without further commercial processing. Consumer goods can further be classified according to the amount of efforts consumers are willing to expend for purchases and the extent of their preferences for such products and services. Thus, consumer goods can be divided into:

- convenience goods
- shopping goods
- specialty goods
- unsought goods.

The functions of marketing can be classified into three, namely merchandising function, physical distribution, and auxiliary function as discussed in unit one.

#### 3.4.1 Convenience Products/Goods

These are standardised products and services usually of low unit values that consumers wish to buy immediately as needs arise and with little buying efforts. That is, goods which consumers generally purchase frequently with little effort. The purchase is almost spontaneous and the person has already, a predetermined brand in mind. These convenience goods include soaps, newspapers, toothpastes, cigarettes, etc. Often, convenience goods are bought impulsively or spontaneously. For example, when a person goes for shopping and sees a product which attracts his eyes, he buys it on impulse. Such goods are not purchased on a regular basis.

#### 3.4.2 Shopping Goods

These are goods which are purchased after going around shops and comparing the different alternatives offered by different manufacturers and retailers. In other words, these are durable items with differentiated product attributes that consumers wish to compare in order to be able to

find the most suitable for their needs before buying. In this case, the emphasis is on quality, price, fashion, style, etc. They therefore have to be marketed differently. Examples of such goods are clothing, household appliances, and furniture.

### **3.4.3 Specialty Goods**

These are products that consumers insist on having. The buyers are willing to wait until the right products are available before they buy them. Consumers have either developed special taste or liking for such goods. Specialty products are usually specific branded items rather than product categories. They are specific products which have passed the brand preference stage and reached the brand insistence stage. Examples of these are cars, jewellery, fashion clothing, photocopy machines, and cameras. They are usually very costly items and include luxury items.

### **3.4.4 Unsought Goods**

These are goods that people do not seek, either because they did not plan ahead to buy them or they did not know about their existence before they saw them on displays at the point of purchase. Most new and recently introduced products will fall into this class. Therefore, aggressive and continuous promotion is necessary for them. Examples of unsought products include life insurance, encyclopedia, and blood donation to the Red Cross Society.

### **SELF-ASSESSMENT EXERCISE**

- i. What is a product?
- ii. What are the levels of a product?

## **3.5 Industrial Products**

These are products that are used by producers who convert them into consumables or consume them in their processes of conversion or production of their goods. Industrial products are those purchased for further processing or for use in conducting a business. The distinction between consumer and industrial goods is based on the purpose for which the particular product was bought. The classification of industrial goods is based on how they are used by industries. Akanbi (2002) classifies industrial products into five namely:

- Installation
- Equipment, Tools and Accessories
- Raw Materials

- Semi-Processed Components and Parts
- Consumables and Operating Supplies.

### **3.5.1 Installation**

These are major capital items that form the main assets of production firms. They are very costly items that need major decisions before they are purchased. They include product items as buildings, heavy manufacturing machines, computers, etc. These are usually custom made items that will require direct negotiations between the buyers and the sellers.

### **3.5.2 Equipment, Tools and Accessories**

These are usually standardised items that are used by a wide range of industrial users. They are products like typewriters, hand tools, filing cabinets, and air conditioners. They are production operating items.

### **3.5.3 Raw Materials**

They form the major parts of the finished items. They are the materials that go through the production line to make up the finished items. They include the raw materials of agricultural products, mining products, forestry products, sea and water products. They are usually standardised items that are sold on the basis of quality and their Reliability of supply.

### **3.5.4 Semi-Processed Components and Parts**

These types of industrial goods also form part of the finished items, although some of them are finished items already like buttons for shirts, radio and batteries for cars. Parts can be used by themselves or can be used to form components of the final items.

### **3.5.5 Consumables and Operating Supplies**

These are the convenience items of industrial products. They are used to aid the running and maintenance of the organisation's equipment and for keeping the organisations and their machines in proper shape. They are usually standardised items and of low prices. Examples are stationery, fuel, water, grease, etc.

## **3.6 Characteristics of Industrial Products**

- i. The demand for industrial goods is derived from the demand for the final goods which they are used to produce. The higher the demand for the final item, the higher will be the demand for the industrial goods and vice versa.

- ii. The demand for industrial goods is mostly inelastic. The amount of items bought of an industrial product remains essentially the same regardless of the price. This is because most items are not
- iii. made of one single product, but a combination of products. For example, a car is made of the body, tyres, radio, air conditioners, lights and so on. If the price of the items is increased, they will still need the same number for each car. Although if the price falls, they may buy more to stock in anticipation of a rise in price in future.
- iv. (Most industrial goods have joint demands with other industrial items. As in (ii) above, most finished goods are a combination of very many products and an increase in the demand for one item will lead to an increase in the demand for the other product.
- v. The industrial goods markets are usually concentrated and few in number than the consumer goods markets. Most of the users of industrial goods are usually concentrated in industrial estates. Government, parastatals and other institutions that use industrial goods are usually concentrated in few locations. The typical industrial buyer is very well informed about what they want to buy. They also know the alternative sources of these items.
- vi. The industrial buying process is usually more rational or the decisions to buy them are more economically based than in the consumer buying process.

### **3.6 Marketing Strategies for Consumer and Industrial Products**

Industrial products are generally subject to greater standardization, as against certain consumer products which require frequent changes in fashion and style. Advertising normally is an important promotional tool for consumer products, but may not be so in the case of industrial

products. Personal selling and after sales service are generally more important for industrial products. Industrial products generally involve high value purchases and this involves competitive bidding based on price competition. Selling is done on the basis of quality or tangible

attributes. As against this, consumer products are very often sold for psychological satisfaction. For example, in case of soaps, Lux soap is said to offer you a complexion like that of a film star!

Consumer products require elaborate channels of distribution, but industrial products are sold through fewer outlets and often directly by the organisation itself. These are some of the salient features of

marketing of consumer products as against industrial products.

### **4.0 CONCLUSION**

A product is the key marketing mix variable on which all the other marketing mix variables revolve. It cannot be diverted from other marketing mix variables, because all of them contribute to form the images of the product from the point of view of the buyers. These images determine the values and satisfaction expected from a given product and how much the buyers will offer for it. It is therefore important for the manufacturers and marketers to understand what a product means to consumers and their expectations from that product.

## **5.0 SUMMARY**

In this unit, you learnt what a product means, various classifications of products and necessary strategies adopted for consumer and industrial products.

## **6.0 TUTOR-MARKED ASSIGNMENT**

- i. What is a product?
- ii. Differentiate the following with the aid of examples:
  - a. Convenience goods.
  - b. Specialty goods
  - c. Shopping goods.

## **7.0 REFERENCES/FURTHER READING**

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## **UNIT 11; MARKETING MIX; CHANNELS OF DISTRIBUTION**

### **CONTENTS**

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Channels of Distribution
    - 3.1.1 Distribution Channel Functions
    - 3.2 Types of Marketing Channels
    - 3.3 The Importance of Channels of Distribution
    - 3.4 Selecting an Appropriate Channel
    - 3.5 Physical Distribution Tasks
  - 4.0 Conclusion
  - 5.0 Summary
  - 6.0 Tutor-Marked Assignment
  - 7.0 References/Further Reading

### **1.0 INTRODUCTION**

Placing goods and services where they are required and when they are wanted is the area of concern of this unit. Marketing channel decisions are among the most important decisions that management faces. A company's channel decision directly affects every other marketing decision. For example, the company's pricing depends on whether it uses mass merchandise or high quality specialty stores. The firm's sales force and advertising decisions depend on how much persuasion, training and motivation the dealers need. Whether a company develops or acquires certain new products, may depend on how well those products fit the abilities of its channel members. Most producers use intermediaries to bring their products to the market. They try to forge a distribution channel either using the existing channels or creating a new independent channel. The use of intermediaries has become necessary in making goods available to target markets, since they cannot have access to the producers directly.

### **2.0 OBJECTIVES**

At the end of this unit, you should be able to:

- explain marketing channels
- explain types of channels
- describe the role of distribution channels in the overall marketing of products
- state the factors involved in selection of an appropriate channel mix.

## **3.0 MAIN CONTENT**

### **3.1 Channels of Distribution**

The term channel of distribution is used to refer to the various intermediaries who help in moving products from the producer to consumers. There are a variety of middlemen and merchants who act as intermediaries between the producers and consumers. Stanton (1981:283) defines a channel of distribution for a product as 'the route taken by the title to the ultimate consumer or industrial users'. A

channel always includes both the producer and the final customer for the product, as well as all middlemen involved in the title transfer. Even though agent middlemen do not take actual title to the goods, they are included as part of a distribution channel. This is because they play such an active role in the transfer of ownership. A channel of distribution is also defined as 'a system designed to move goods and services from producers to customers, which consists of people and organizations supported by various facilities, equipment, and information resources'. However, Armstrong and Kotler (1994) reports that distribution channel is 'a set of interdependent organisations involved in the process of making a product or service available for use or consumption by the consumer or industrial user'.

Channels of distribution are the most powerful element among marketing mix elements. Many products which were intrinsically sound have died in their infancy because they never had the right road to the market. However, by developing a sound distribution network and launching aggressive advertisement campaigns, a company can carve out a niche for itself. Many Nigerian manufacturers took advantage of the distribution network built by erstwhile companies. This may be attributed to costs and time and goodwill of the distributors concerned. However, it is better to study the distribution network before launching a product.

Channels of distribution help movement of goods from one place to another and thus create place utility. They make it possible for the consumer to get the goods when he wants them and thus create time utility. They bring goods to the consumer in a convenient shape, unit, size, style and package and thus create convenient value. They make it possible for the consumer to obtain goods at a price he is willing to pay and under conditions which bring him satisfaction and pride of ownership and thus create possession utility.

It should however be noted that the concept of marketing channels is not limited to the distribution of physical goods alone. Producers of services and ideas also face the problem of making their goods accessible to their target consumers. Channels of distribution can be grouped under two major headings namely, Direct Selling by Manufacturers and Indirect Selling through Middlemen.

### **3.1.1 Distribution**

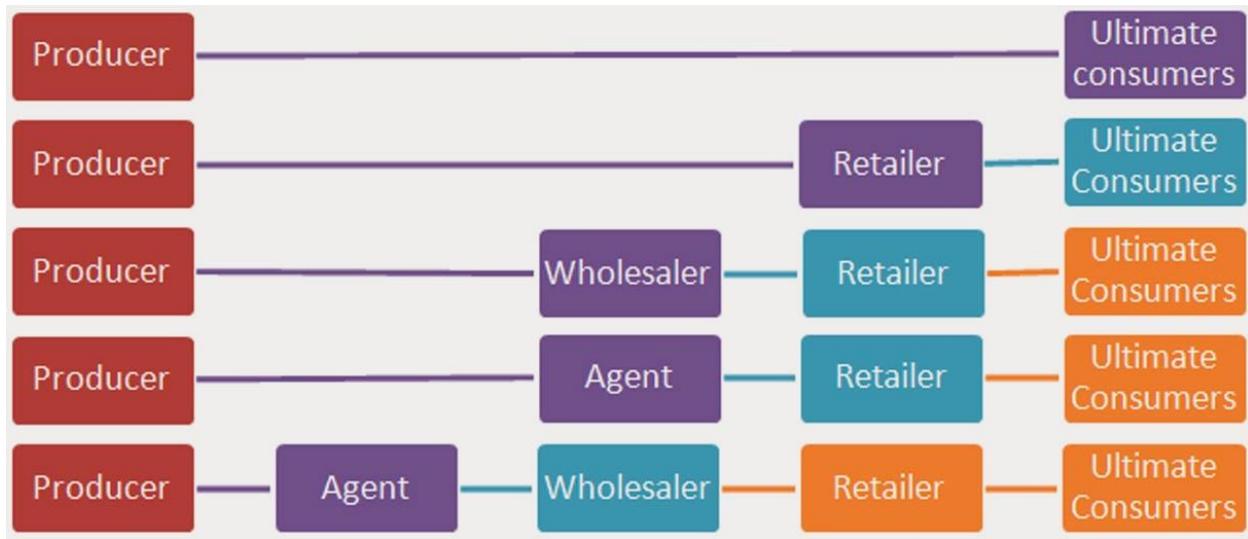
The functions performed by the members of the marketing channels include:

- a. Information:** Gathering and distributing marketing research and intelligence information about actors and forces in the marketing environment, needed for planning and aiding exchange.
- b. Promotion:** Developing and spreading persuasive communications about an offer.
- c. Contact:** Finding and communicating with prospective buyers and suppliers.
- d. Matching:** Shaping and fitting the offer to the buyer's needs, including such activities as manufacturing, grading, assembling and packaging.
- e. Negotiation:** Reaching an agreement on price and other terms of the offer so that ownership or possession can be transferred.
- f. Physical distribution:** Transferring and storing goods.
- g. Financing:** Acquiring and using funds to cover the costs of the channel work.
- h. Risk-taking:** Assuming the risks of carrying out the channel work.

### **3.2 Types of Marketing Channels**

Marketing channels can be described by the number of channel levels involved. Each layer of middlemen that perform some work in bringing the product and its ownership closer to the final buyer is a channel level. Because the producer and the final consumer both perform some work, they are part of every channel. We use the number of intermediary levels to indicate the length of a channel. All of the institutions in the channel are connected by several types of flows. These include the physical flow of products, the flow of ownership, the payment flow, the information flow, and the promotion flow.

We shall now take a look at two types of marketing channels – channels for consumer goods and channels for industrial goods.



**Fig. 1: A Channel for Consumer Goods**

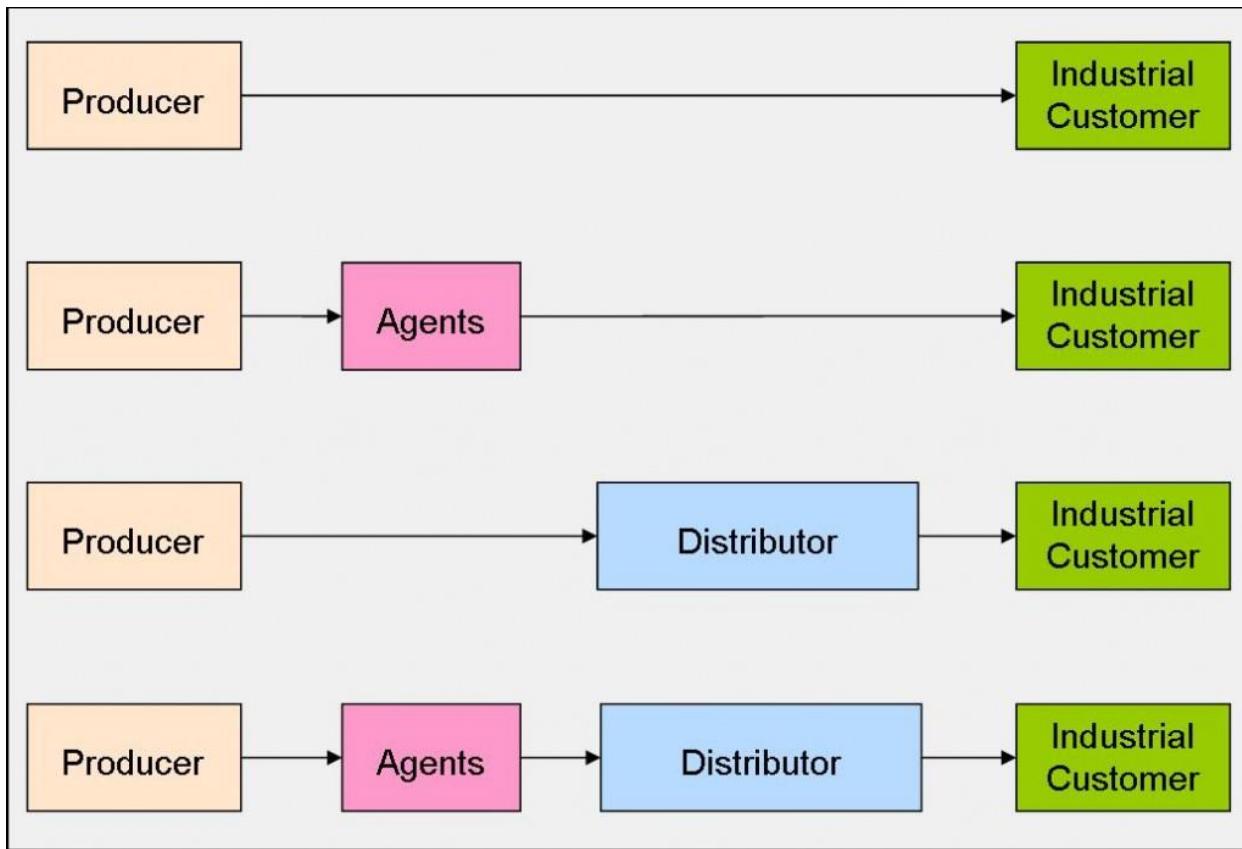
Source: Armstrong & Kotler (1984)

**(1) Producer to the Consumers:** When there are no intermediaries between the producer and the consumer, the channel is direct. This type of channel is most commonly used with organisational products, especially where the product is new. This is aimed at creating awareness and to gain access to target consumers.

**(2) Producer to Retailer to the Consumer:** The channel from producer to retailer to the consumer is common when the retail establishments involved are relatively large.

**(3) Producer to Wholesaler to Retailer to the Consumer:** The most common channel for consumer goods. It employs a wholesaler to take care of the shipping and transportation needs. Wholesalers offer the accumulating and allocating functions that allow small producers to interact with large retailers, and vice versa.

**(4) Producer to Wholesaler to Jobber to Retailer to the Consumer:** the producer chooses to use agents (Jobbers) to assist the wholesalers in marketing goods. The use of Jobbers could be attributed to their specialised experiences.



**Fig. 2: Channels for Industrial Goods**

Source: Armstrong & Kotler (1994)

- 1. Manufacturer(producer) to Industrial Customer (Buyer):** From the diagram above, manufacturers use direct marketing to distribute their products to the industrial users. This is mostly associated with complex products that require a good deal of pre-sale and post-sale support. It should be noted that post-sale support is often best handled through a direct channel, because the manufacturer might be the only entity with sufficient expertise to help the customer because these large accounts generate enough business to support the sales effort involved, and because large customers have a habit of going through their economic weight to demand for personalised service.
- 2. Manufacturer to Industrial Distributor to Industrial Customer:** This is the most used channel for industrial products. Distributors take title to the goods and specialise in different lines of goods. Some of the disadvantages associated with this channel are that:

- a. Distributors will want access to large accounts that the manufacturer may try to keep for itself
- b. Distributors try to keep their product selections wide, which frequently means carrying competing lines
- c. Sometimes distributors do not always respond to manufacturers' advice regarding promotions, pricing and operational policies.

3. This channel of distribution for industrial goods is mostly adopted by manufacturers which wish to maintain control over their products. It also applies to those goods that are sold across countries. Other factors include cultural factors, and government policies, etc.

4. The fourth channel of distribution is adopted by manufacturers which wish to have control of marketing activities of their products. However, some titles to the goods are given to industrial distributors, who sell to the industrial customers when needed and at the quantity needed.

### **3.3 The Importance of Channels of Distribution**

The importance of channels of distribution is summarised below:

- 1. Channels of distribution are the most powerful element among marketing mix elements. Many products which were intrinsically sound died in their infancy because they never found the right road to the markets.
- 2. Channels take care of the transaction aspects of marketing, including the selling, the financing and the risk taking associated with strong products in anticipation of future sales.
- 3. They perform the logical function of moving products from the point of production to the point of purchase.
- 4. They help producers promote goods and services.

### **3.4 Selecting an Appropriate Channel**

The channel decisions are important (for two reasons). The costs involved in the use of a channel entail the price that the consumer has to pay. The channel decision also has a bearing on other marketing decisions like pricing and product line. Through proper market feedback, an appropriate selection of channels can reduce fluctuations in production. A rational decision regarding choice of channels of distribution should ensure:

- (a) maximum geographical coverage of the markets
- (b) maximum promotional efforts, and
- (c) minimum cost.

The following factors usually govern the selection of channels:

#### **(1) The Type of Product**

For selling perishable products like bread and milk or vegetable, it is important to have a short channel of distribution which facilitates quick movement from the factory to the consumers. Limited channels may also be employed where the movement of goods involves heavy freight and poses problems of transportation for such goods as furniture, refrigerators, and air conditioners. But distribution of products having lower units and high turnover involves a large number of middlemen as in the case of products matches, soap, and toothpaste. When the product requires after-sale service, as in the case of television, air conditioners, and automobiles, the choice of middlemen may be limited to only those who are in a position to provide these services. Since not many middlemen may be capable of providing such services, again their number may be limited.

#### **(2) Nature and Extent of the Market**

If the number of consumers is small as in number ... is the case of bulky and expensive machinery, the manufacturer may approach the customer directly through his own sales force; so also, if the consumers are concentrated in a limited geographical area. If the above conditions are not applicable, a longer channel may have to be chosen. However, for industrial goods where such goods are bulky, manufacturers may adopt direct selling/marketing.

#### **(3) Competitive Characteristics**

It is a wise policy to study the existing channels of distribution, particularly those used by competitors. Channels design is influenced by the competitors' channels. Producers may want to compete in or near the same outlets carrying the competition channels. However, where an established channel exists, the manufacturer may make use of customary channels. For example, for soap and toothpaste, grocery stores are commonly used.

#### **(4) Costs Involved in Distribution**

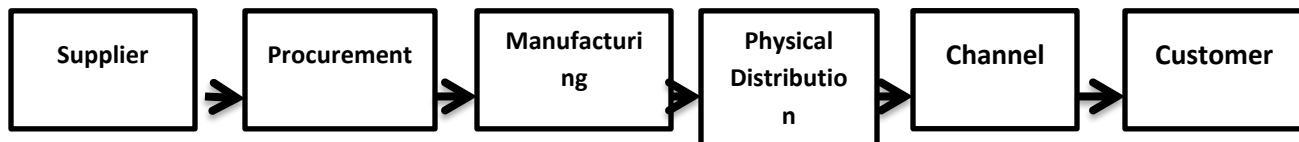
Cost, no doubt, is a very important consideration. The longer the channel of distribution, the greater the cost. Thus, manufacturers look for ways to keep down the cost and prefer distribution through middlemen who have their own established sales force as it is more economical and involves less financial commitment. Wholesalers shoulder some of the responsibilities of cost of stocking and transporting goods. But the manufacturers have to provide them with a margin which will either reduce their costs or increase the cost to the buyers.

However, in making a choice, the manufacturer has to consider his objectives, resources and the channels available to him after considering the above factors. He/she would like to use the channel of distribution which will produce the combination of sales volume and cost that yields the maximum amount of profits. There are no set guidelines for channel selection; therefore, manufacturers will have to take their own decisions in the light of their own judgments and experience. But most companies like to use multiple channels of distribution to ensure that their products reach the maximum number of people.

The task of manufacturers does not end after the channels have been selected. They have to review the services performed by these agencies involved at fairly frequent intervals. They should keep in close touch with the changes related to the distribution of their products, and seek to improve their marketing methods constantly.

### 3.5 Physical Distribution Tasks

Producers/manufacturers must decide on the best way to store, handle and move their goods and services so that they are available to customers at the right time and place. Producers typically need to employ the services of physical firms – warehouses and transportation companies - to assist in this task. Armstrong and Kotler (1994) observed that physical distribution involves planning, implementing, and controlling the physical flow of materials and final goods, from points of origin to points of use, to meet customer requirements at a profit. The aim of physical distribution is to manage supply chains and value-added flows from suppliers to final users, as shown below:



**Source:** Armstrong and Kotler (1994). *Principles of Marketing*. 6<sup>th</sup> Edition. Englewood Cliffs, New Jersey

There are several tasks that have to be accomplished as part of physical distribution. These are:

- 1. Location of Manufacturing Facilities;** There are two interrelated issues. Firstly, where to locate the manufacturing facility and secondly, how many facilities should be set up. The basic decisional parameters would be the availability of the basic raw material and the location of the market. It may decide to locate the manufacturing facility nearer to the source of supply and ship the finished outputs

to the outlying markets or to erect the production facility near the geographical market to be served and arrange the shipment of the inputs. The location of NNPC for example, in Port Harcourt was based on the availability of raw material (crude oil) yonder. The basic consideration involved obviously is the relative costs of transporting inputs and outputs, including the economics of different modes of transportation which may be used to transport raw materials and finished products.

2. **Location of Warehouses;** One important consideration in this context is the nature of the product being sold. If the product is a household item, such as tea, soap, or toothpaste, the retail outlets will be at the bottom of the distribution channel. A manufacturer of capital equipment on the other hand, can have only one centralised warehouse for the main product, but has to maintain a number of service centres to stock spare parts.
3. **Mode and Method of Transportation;** There are several key decisional points in this context which for long were considered the heart of distribution management. These are:
  - a. Which mode of transportation would be optimal?
  - b. Which method of distribution would be optimal?
4. **Inventory Decisions;** Inventory holding costs are always on the increase due to all round increase in prices as well as cost of capital. As a result, very careful attention has to be paid to how much inventory should be maintained, of what items and where. Many of these decisions have to be taken, keeping in view the broader corporate objective of service reliability, i.e. the capacity of the firm to deliver on time.
5. **Using External Distribution Agencies;** Much of what has been discussed above refers to firms which want to distribute products on their own. However, a firm may decide that because of resource constraints or lack of in-house expertise, it would like to concentrate on production and leave the task of distribution to an outside agency such as Independent Marketers in Nigeria. Whether to contract out distribution or not, is a major decision and would require an in-depth analysis of the relative costs and benefits, both tangible and intangible, of the alternative courses of action.

## 4.0 CONCLUSION

Distribution is the all-important link between a manufacturer and his customers. The concern is for designing a distribution strategy to facilitate the smooth physical flow of products from the manufacturers to the place where the customers can buy them. Channels of distribution refer to the alternative paths through which the goods can be routed. Direct selling and indirect selling through intermediaries such as wholesalers and

retailers are the two alternative channels of distribution to choose from. The final choice will depend on the type of product which you are dealing with, number and location of customers and their buying habits and costs involved. The manufacturers should also consider the specific advantages of each type of intermediary before taking a final decision.

## 5.0 SUMMARY

In this unit, you learnt what marketing channels are, the role of distribution channels in the overall marketing of products, and factors responsible for selecting an appropriate channel mix.

## 6.0 TUTOR-MARKED ASSIGNMENT

- i. Explain factors to be considered while selecting an appropriate channel of distribution.
- ii. Briefly explain the term “Marketing Channels”.

## 7.0 REFERENCES/FURTHER READING

Armstrong, G. & Kotler, P. (1994). *Principles of Marketing*. 6th Edition. New Jersey: Englewood Cliffs.

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## UNIT 12; MARKETING MIX; PROMOTION

### CONTENTS

- 1.0 Introduction
- 2.0 Objectives
- 3.0 Main Content
  - 3.1 Role of Personal Selling
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  - 3.3 The Selling Process
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  - 3.5 Sales Promotion Objectives

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## **1.0 INTRODUCTION**

In contrast to advertising and publicity, which use impersonal methods of communication, personal selling makes use of direct personal communications to influence the target customers. Personal selling is a highly distinctive method of promotion, and makes use of oral presentation in conversation with existing and potential customers, for the purpose of making a sale. It is one of the oldest methods of business promotion. The contributions made by personal selling in making the promotion function more effective have earned it the distinction of being the most reliable promotion method. Though, it is the most expensive method of promotion, yet we see an increasing number of firms making use of it, and a good number of them realise that they cannot, perhaps, live without it. Increasing competition and the growing sophistication of the buyer and his/her buying process are making personal selling more or less indispensable. Sales promotion is the only method that makes use of incentives to complete the push-pull promotional strategy of motivating the sales force, the dealer and the consumer in transacting a sale.

## **2.0 OBJECTIVES**

On completion of this unit, you should be able to:

- explain the nature and role of personal selling and sales promotion
- list different types of sales position and sales promotion schemes
- describe the steps involved in the selling process
- explain the growing importance of sales promotion in Nigeria.
- explain the process involved in planning sales promotions
- outline the need for integration among the different methods of promotion.

## **3.0 MAIN CONTENT**

### **3.1 Role of Personal Selling**

Personal selling is defined as ‘Oral presentation in a conversation with or more prospective purchasers for the purpose of making sales’. Personal selling, as the name implies, is an individual selling. It, therefore, carries the distinctive advantage of

flexibility in terms of tailoring the sales presentation to the needs of the buyer. Another unique advantage comes from its two-way communication and human interaction, thereby providing instant feedback. These two unique advantages make personal selling the most result-oriented promotion method.

Generally speaking, the nature of goods marketed, as well as the distribution system adopted; determine the role of personal selling in a firm. Therefore, personal selling is used extensively in the case of industrial goods, where the salesperson performs functions such as assisting the customer in designing the product specifications, product installation, product commissioning, solving technical problems through providing service after sales and helping the customer to have optimal utilization of the product. In the case of consumer goods, on the other hand, the role of personal selling gets usually restricted to the dealer level. The scope of the tasks performed include obtaining periodic orders, ensuring supplies, offering tips to dealers on product display and attaining desired levels of stock movement. Similarly, the role played by personal selling is more in a firm, which uses the door-to-door selling method through its sale force than in the firm, which sells through large stockists, distributors or sole-selling agents.

Notwithstanding the varying role of personal selling in the strategies followed by different companies, the nature of the selling function requires that the following tasks be performed:

- Sales generation
- Feedback and market information collection
- Provision of customer service covering aspects such as delivery of goods, warranty administration, timely availability of repair and spares, etc.
- Performance of sales support activities such as monitoring the distribution function, credit collection, improving manufacturer dealer relations, implementing the promotional programmes, etc.

In practice, the complexity of the selling task actually performed varies from company to company even under the above four categories.

### **SELF-ASSESSMENT EXERCISE 1**

Define personal selling. Name two advantages personal selling have over other kinds of promotion.

### **3.2 Types of Selling Jobs**

From the foregoing discussion, we understand that while sales as a function has a common purpose that is to effect sales the selling situations differ due to the interplay of various factors. These factors are nature of goods sold, type of distribution system used, nature of demand and the type of sales strategy followed by the firm. These factors

require the sales force to possess different traits and abilities suitable to the selling situation with which they are associated. To underscore the differences, Robert N. McCurry in 'The Mystique of Super salesmanship' classifies individual sales positions based on the degree of creativity required into seven categories. These seven categories are described below.

- a. Merchandise Deliveries;** This is the sales person, whose primary job is to deliver the product usually against routine orders, popularly called sales and delivery boys.
- b. Inside Order-taker;** Working inside a store the primary job of such a salesperson is to service the customer's request or suggest appropriate products to meet customer wants. Such type of salespersons are popularly called retail salesman.
- c. Outside Order-Taker;** The salespersons engaged in the task of taking orders from the resellers. They normally do not use the hard selling approach for making orders.
- d. Missionary Salesperson;** The salesperson whose primary job is to educate, give product detailing, build goodwill or create primary demand for the product. Strictly speaking, missionary salespersons are not permitted to take orders.
- e. Sales Engineer;** The salesperson, who acts as a technical consultant to the client and as per the need, helps to design products or production system for a client. This type of salesperson is popularly called Technical Salesperson, e.g. Computer salesman.
- f. Tangible Product Seller;** The salesperson' job is to sell tangible products such as furniture, appliances, automobiles, etc. The job involves abilities to persuade and convince the customer.
- g. Intangible Products Seller;** Here the salesperson is associated with selling intangible products or services such as advertising services, insurance, education, etc., the common factor being difficultly in immediate demonstration of the perceived benefits of the product. This selling job requires perhaps the greatest degree of creativity in the salesperson.

### **Defining the Salesperson's Job**

The foregoing classification of the sales position into seven categories, on the basis of degree of creativity required in the performance of each job is only general in nature. Depending upon the organizational need, each company should clearly define what it

expects from a salesperson in terms of the tasks to be performed by him. It should broadly specify how much of the salesperson's time should be spent on developing new accounts versus servicing existing accounts, large accounts versus small accounts, bulk order versus small orders, selling individual products versus selling products line, selling old products versus selling new products, etc. Lack of clear definition regarding the selling tasks to be performed often results in disproportionate spending of time between the tasks, as well as in imbalances in the goals achieved. To avoid this type of loss in productivity of the sales force, it is worth repeating that the job of a salesperson should be defined with sufficient specificity, so that he/she can use it as a guideline to stay in the right direction.

### 3.3 The Selling Process

Up to this point, we have been discussing the role of personal selling and the degree of creativity required in a salesperson to perform the task satisfactorily. Now we will take a look at the selling process followed for completing a sale. Though the steps in the selling process discussed below will be applicable to most of the selling situation, what will differ will be the degree of importance given to each steps of the process under different selling situations. The basic step in the selling process is given in Figure

1. A salesperson must become accomplished at performing the selling steps.

These steps are:

- a. Preparation
- b. Prospecting
- c. Pre-approach
- d. Approach
- e. Sales representation
- f. Handing objections
- g. Closing the sale
- h. Post-sale follow-up.

Resources customers on the correctness of their decision. Checked whether the order was filled and delivered when promised. Make certain product is properly installed, used and served.	SALE POST FOLLOW-UP
Make conscious effort to close. Don't be afraid of being rejected.	CLOSE THE SALE
Understand reasons for objection	HANDLING

Have a positive attitude. Avoid arguments.	OBJECTIONS	
SALES PRESENTATION		Arouse Desire
APPROACH		Make initial contact with prospect
PRE-APPROACH		Study the organisation And those involved in buying
PROSPECTING AND QUALIFYING		Develop sales leads from various sources Separate the suspects from the prospects
PREPARATION	Know your product. Know your customer. Know your competitor. Know your company	

**Fig. 1: Steps in the Selling Process**

Sources: Ralph M. Gaedeke & Dennis H. Tootelian (1983)

## Step 1

**Preparation:** Before starting the selling job, a salesperson should make a valuable investment of time and resources to know the products to be sold, know the customers (i.e. customer types, buying motives and buying process) to whom he will be selling, know the competitors against whom he will be selling, and finally know the philosophy, policies and range of products of his company. In short, he should be well equipped with the fundamentals of selling.

## Step 2

**Prospecting:** This step of the selling process deals with the location and preparation of a list of prospective customers. Prospects can be located through (1) identifying the potential of buying more in the existing customers, (2) recommendations of existing customers, (3) winning back lost customers, (4) attracting competitors' customers, (5) customers' information request from advertisement, (6) newspaper announcements, (7) public records, (8) directories like telephone, trade associations etc., (9) other salesmen, (10) references from friends, neighbors and business associates, and (11) cold canvassing, that is, going from door-to-door.

The located prospects should first be qualified broadly in terms of (i) whether they want the product and how intense their want is, (ii) whether they have the adequate purchasing power, and (iii) whether and who possesses the power or authorization to purchase and spend the required money. The qualifying of prospects is the process of separating the prospects from the suspects.

It is worth mentioning here that the ability to prospect is the most essential ability of a **successful salesperson**. A good salesperson keeps examining, weeding out the already tapped prospects and updating his/her lists of prospects, and remains in constant search of new prospects.

### **Step 3**

**Pre-approach:** The qualifying process of separating prospects from suspects further requires that the salesperson should possess detailed information relating to the prospects in terms of existing products consumed, their scale of operation, product range, their buying size, frequency, budget and the process, etc. In short, obtain customer orientation. The sources of information for the purpose include company annual reports, other salespersons, other suppliers to the prospects, census of manufacturers, professional journals, newspapers and market intelligence. The availability of the above information in as detailed a manner as possible will help the salesperson in ranking the prospect in classifying the prospects in A, B, and C categories in terms of the immediacy of the attention to be given to them.

### **Step 4**

**Approach:** ‘First impression counts.’ As such, this step needs to be carefully planned. This step has two distinct parts. One, of meeting the customer with a positive set of mind, and the second is make an impact on him. For the former, referrals of reliable persons known to prospects, calling after fixing an appointment, use of door openers, help. For the latter the salesperson should equip himself with key benefits to be emphasized, samples or new literature to be handed over, etc.

### **Step 5**

**Sales Presentation:** Through advance information relating to the prospect, every effort should be made to match the product offered to the needs/problems faced by the customer. The sales presentation should generally go according to the AIDA—attention, interest, desire, and action approach. How can this be done? Use of key benefit or a problem solver, or a unique act of the salesperson results in gaining attention. When used

attentively this part also provides an opportunity to get the main point of the initial statements made by the prospect.

The presentation should proceed in a straightforward manner to help the prospect know that you understand his problem and that is the reason of your being there. To convince the prospect as early as possible, the salesperson should offer evidence through demonstration of the product, use of exhibits, models, sharing of acts, citing examples of successful applications/usage, showing testimonials, etc. The overall approach should be to build credibility and confidence in the supplying company, its products, and also in its competence to render specialized type of service to the complete satisfaction of its customers.

The flexibility of the sales presentations can range from the 'canned' or previously prepared presentation, to those allowing the salesperson complete freedom in the presentation. Though both extremes, and even the hybrid of the two, have their own situational suitability, the important point to note is that salesmanship, being a showmanship function, must arouse active participation of the prospect in the presentation process. This can be done by introducing some action which would keep the prospect captivated. One possible way would be a joint review of the problem faced by the prospect. Another is helping the prospect imagine the projected benefits of owning the product.

## Step 6

**Handling Objections:** It is in the last phase of the sales presentation step that the prospects start expressing doubts, or raising objections whether relating to price, need for more time to think, satisfied the existing product/supplier or product quality claims.

These doubts or objections should be welcome and they should be answered with confidence. There is certainly no doubt that the prospect has to be thoroughly convinced that the product would satisfy his need. The ability of the salesperson in mind reading the prospect, enables him to anticipate the prospect's objections and reactions.

The golden rules for handling objections are:

1. Welcome the objection and show respect to the prospect, and
2. Do not argue with the prospect. Even when the objections raised are half-backed or trivial in nature, the salesperson should handle the situation tactfully. Only in extreme necessity, should a salesperson ask the prospect to adequately explain the problem faced. Even under these circumstances, courtesy should not be lost sight of, and while the discussion is on, the salesperson should start recounting the benefits of the product agreed upon, and lead the prospect to make a favourable

decision. It should be remembered that handling objections sharpens the selling skills of the salespersons.

## Step 7

**Closing the Sale:** Closing is that aspect of the selling process in which the salesperson asks the prospect to buy the product. There is a critical point during each presentation when the salesperson should ask for the order. Pending the location of the critical point, as the objections are being met, the salesperson should help reduce the choice of options, summarize the benefits of buying, and the consequences of buying, and if need be, make use of the big idea appeal of the buying 'now' at that moment.

The salesperson should have the ability of catching the buying signals given by the prospect and should act on them fast. Some of such signals are changing the sitting/standing position and moving closer to the product; reading the instructions on the product; perusing the testimonials; showing hesitation in being able to afford; asking for another demonstration, if applicable; checking the warranty or asking questions relating to warranty terms. These signals show that the time is ripe to start taking the order.

## Step 8

**Post-sale Follow-up:** The selling process does not come to an end by writing the order. A few repetitions reassuring the benefits of the product keep the customer sold. Follow-up provides an opportunity to ensure that the product is being rightly used, and if necessary to re-explain the method of using, handling, and storing of the product when not in use. This builds favourable feelings and nurtures the strong buyer seller relationships. Post-sale follow-up not only reinforces the customer's confidence in the salesperson and his company but also tends to keep competition out. This also helps generate repeat business and valuable word-of-mouth publicity. The follow-up is a good source of feedback too.

Let us conclude this section by stating that although the eight steps of the selling process are essential in spirit, these may not always be followed. This could be partly the (1) the selling situation involved (e.g. in the case of insider order-taker or retail salesperson the first three steps of the selling process are generally not applicable as the customer walks into the store for buying a product), (2) the expertise of the salesperson (such that he can ignore or assume some information), or (3) the seller's market of the product where customers generally queue up for the product.

Let us also look at the findings of a study by Robertson and Chase on the subject. They point out that:

1. The more closely matched the physical, social and personal characteristics of the customer and salesperson, the more likely is the sale.
2. The more believable and trustworthy the customer perceives a salesperson to be, the more likely is the sale.
3. The more persuadable a customer is, the more likely is a sale.
4. The more a salesperson can make prospective buyers view themselves favorably, the more likely a sale is.

Before you read further, attempt this exercise.

### **SELF-ASSESSMENT EXERCISE 2**

What general procedure should be followed when qualifying prospects?

#### **3.4 Sales Promotion**

Of all the methods of promotion that constitute the promotion mix, sales promotion is the only method that makes use of incentives to complete the ‘push-pull promotional strategy of motivating the sales force, the dealer and consumer in transacting a sale.

There is no single universally accepted definition of sales promotion. One can, however, gather its essence by perusing a few definitions. Let us look at some of the popular definitions of sales promotion:

According to the American Marketing Association, sales promotion refers to:

*‘those activities other than personal selling, advertising and publicity, that stimulate consumer purchasing and dealer effectiveness, such as display shows and exhibitions, demonstrations, and various other non-recurrent selling efforts not in ordinary routine.’*

This definition suggests that sales promotion is a catch-all for all those promotion activities which do not fall clearly into advertising, personal selling or publicity.

**Roger A. Strang offers a simple definition** ‘*Sales Promotion is short term incentives to encourage purchase or sale of product units or service.*’

Yet another definition that seems fairly exhaustive, and hence, will be used in this unit is the one given by Stanley M. Ulanoff in his *Handbook of Sales Promotion*. Stanley defines sales promotion as:

*‘all the marketing and promotion activities, other than advertising, personal selling, and publicity, that motivate and encourage the consumer to purchase by means of such inducements as premiums, advertising specialties, samples, cents-off coupons, sweepstakes, contests, games, trading stamps, refunds, rebates, exhibits, displays, and demonstrations. It is employed as well, to motivate retailers’, wholesalers the*

*manufacturer's sales forces to sell through the use of such incentives as awards or prizes (merchandise, cash and travel), direct payments and allowances, cooperative advertising, and trade shows'.*

It offers a direct inducement to act by providing extra worth over and above what is built into the product as its normal price. These temporary inducements are offered usually at a time and place the buying decision is made.

Summing up, sales promotion deals with promotion of sales by the offer of incentives which are essentially non-recurring in nature. It is also known by the names of Extra-Purchase-Value (EPV) and below-the-line- selling.

Like in other market economies, the use of sales promotion is catching on in Nigeria in terms of volume. The number of sales promotion schemes offered to the consumers alone has grown by over seven times in the first three years of the eighties as against the average in the seventies. The schemes offered at the dealer level also nearly doubled during the period 1978-79 and 1982-83. In terms of the expenditure incurred, the large size companies are stated to be spending between 40 and 50 per cent of their advertising and sales promotion budget on this activity.

In terms of product groups, the major users of sales promotion are: tea, coffee, and beverages, soaps, detergents and washing soaps, toothpaste, textiles, food products and baby foods, household remedies, and consumer durables like fans, refrigerators, sound systems, television and other household appliances.

Among the various types of sales promotion schemes used, **contests** at the consumer, dealer and sales force levels have made a significant headway.

## **Why Rapid Growth?**

A perusal of the list of the product groups which emerged as the major users of sales promotion, and from the market feel, it seems clear that a transformation from the seller's to the buyer's market is taking place and marketing has become more competitive in these product markets. In addition to increasing competition, other reasons for rapid growth of sales promotion in Nigeria as pointed out by some large sized cooperating companies in surveys are summarized below:

- sales promotion makes an immediate effect on sales.
- measurement of the effectiveness of sales promotion is easier as against other promotional methods.
- channels of distribution are emerging as powerful entities and demand greater use of incentives to get desired results.
- products are becoming standardised and similar, and so need increased support of non-price factors of which sales promotion is an important one.

- impulse buying is on the increase, and so is the rise in the number of marginal customers. With virtually no brand loyalty, offer of attractive schemes helps manufacturers to induce such customers to choose their product.

### **3.5 Sales Promotion Objectives**

As a powerful method of sales promotion with a capability to complement and supplement the advertising function of marketing, sales promotion helps marketers realise a variety of objectives. These objectives could relate to the promotion of sales in general, or to a specific activity at a particular level, i.e. the consumer, dealer or sales force. Some of the commonly attempted objectives are to:

- increase sales (in general, and focusing on new uses, increased usage, upgrading unit of purchase, winning sales of fading brands, etc.)
- make the sale of slow-moving products faster
- stabilise a fluctuating sales pattern
- identify and attract new customers
- launch a new product quickly
- educate customers regarding product improvements
- reduce the perception of risk associated with the purchase of a product
- motivate dealers to stock and sell more (including complete product lines)
- attract dealers to participate in manufacturer's dealer display and sales contest
- obtain more and better shelf space and displays
- bring more customers to dealer stores
- make goods move faster through dealers
- improve manufacturer-dealer relationship
- motivate sales forces to take the achievement higher than targets
- attract sales force to give desired emphasis on new accounts, latent accounts, new products, and difficult territories
- reward sales forces for active market surveillance and for rendering superior customer services
- put power into the sales-presentation
- counter competitors sales-promotion and marketing efforts
- provide punch to the company's advertising efforts
- Build goodwill.

Companies may use any one or a combination of the above objectives in varying forms to suit the product-market needs of their product. What is of significance is that the sales promotion and marketing objectives are pursued by the company.

### **SELF-ASSESSMENT EXERCISE 3**

Can you recall any 10 sales promotional objectives just read? Please itemize them.

### 3.6 Sales Promotion Methods

Many methods of sales promotion are used by marketers. Depending upon the creativity level of their sponsors, their variety seems very large. We refer here to some of the most commonly used methods of sales promotion. As noted above, the accomplishments of the desired promotion and marketing objectives ultimately depend on the extent of the desired response received from consumers, dealers and members of the sales force. Hence various sales promotion methods are built around these three target groups. Further, in terms of the impact desired, the variety of sales promotion schemes offered are grouped into two categories: one, aimed at producing immediate impact, and the other delayed impact i.e. carrying on the impact over a period. Immediate impact schemes are those schemes where the consumer, dealer or salesperson gets the incentive on first contact, purchase or on performing a one-time act. On the other hand, under the delayed impact schemes, the consumer, dealer or sales force is called upon to comply with the scheme over a period of time before receiving the full benefit of the scheme. Price discounts, free samples of large quantity packs are the popular examples of immediate impact schemes, whereas coupons, trading stamps, and contests are example of delayed impact category of sales promotion schemes. Table 2 presents the variety of sales promotion schemes directed at the consumer, dealer and sales force levels according to their grouping under immediate impact or delayed impact categories. The meaning and objectives of these schemes are given in Table 2.

**Table 2; Sales Promotion**

Impact	Users	Non-Users	Trading/Suppliers	Sales force
Immediate	Price Off	Price-Off	Discount allowance	Pre-requisite
	Quantity- Off	Sampling	Shell space allowance	
	Over the counter	Over-the-counter		
	Package Premium Branded Premium Container Premium	Gift Push money Position of sales force		
	In Production	Media Dorr	Merchandise	Sales contests

Delayed over a period of time	Coupon	Coupon	Deals	
	Personality	Returns	Coupons	
	Premium offers	Refund	Displayed contests	Honors and recognition
	Trading stamps	Cooperative allowance		Customer service awards
	Self-liquidators	Sales contest		
	Contents/Lucky Draws			

Source: Donald W. Cowell's article on Sales Promotion and the Marketing of Local Government Recreation and Leisure Services, *European Journal of Marketing*, 18.2.

**Table 3: Sales Promotions: Meaning and Objectives**

S/N	SALES PROMOTION	MEANING	OBJECTIVES
1	Price-Off Offers	Offering product at lower than the normal price.	To encourage immediate sales, attract non-users, induce new product trial, counter competition, inventory clearance at the retail level, inventory build-up at the trade level.
2	<b>Quantity-Off Offers</b>	Offering more quantity of the same product at no extra cost or with a very nominal increase in the price of the larger quantity packs	To encourage more/longer duration consumption, higher or excess quantity movement from the factory, trade up consumer for higher quantity packs size.
3	<b>Premium</b> packs.	Offer of an article of merchandise as an incentive in order to sell product or service. Its forms are;	To encourage purchase, stimulate loyalty, off-season sales promotion, induce trial of new product, ensure reach of premium to the consumer.
	a. Packaged premium	When the incentive article is packed inside the package of the product	
	b. Branded premium	Where the premium article is handed to the package of the product say with cello tape, etc.	Sampling new products, adding speed to show moving products.
	c. Over-the-	When the premium article	To counter competition,

	Counter premium	is neither inserted inside nor branded to the product package but is given away to the consumer over the counter along with the product package.	improve inventory clearance at the trade level.
	d. Container premium	When the product itself is home placed in an attractive and reusable container which serves as a gift.	As a durable reminder at home.
	e. Self-Liquidating Premium	Where the consumer usually is asked to pay a specified amount to liquidate or offset a part or full cost of the premium article or the scheme administration costs	To induce consumer to appropriate premium article, reinforce brand image, encourage more consumption, enables sponsor to offer better quality premium.
	f. Personality premium	Where the consumer is required to redeem a specified proof-of-purchase.	To build loyalty and reward the consumer for that to counter to purchase for the premium article. Proof-of-purchase may be labels, pack tops, bottle tops, corks, etc.
4	Coupons	When the consumer is entitled to redeem a specific standard certificate for a product/article free or a part payment. Coupons are used by both the manufacturer and the dealers for sales promotion. Coupons may be distributed by mail, by media advertisements, door-to-door, inside product package or by dealers on purchase.	To encourage product trial, build loyalty, trade-up regular users, stimulate re-purchase rate, and solicit inquiries.
5	Refund Offers	Offer of a refund of money to the consumer for mailing in a proof-of-	To induce trial from primary users, motivate several product purchase,

		purchase of a particular product	obtain displays at the retailers, help retailers tie-in with other products, switch competing brand users to sponsor's brand, loading dealers with increased stock.
6	Trading stamps	Organized by trading stamp companies or large retailers. Trading stamps are a kind of discount coupons offered to consumers linked with the quantum of the purchase.	To encourage consumer loyalty to certain retail stores.
7	Consumer contests and lucky draws	Where individuals are invited to compete on the basis of creative skills. The latter is based on the chance or luck factor	To create brand awareness and stimulate interest in the brand, acquaint consumers with brand usage and benefits, build traffic at the store, precipitate brand purchase, obtain consumer feedback, promote advertising scheme of the company.
8	Dealer Stock Display Contest	It is a type of point-of-purchase advertising which uses the show windows of the dealers for providing exposure to the sponsor's products. Dealers participating enthusiastically and creatively are rewarded.	To provide product exposure at the point of purchase, generate traffic at the store, infuse enthusiasm among dealers.
9	Dealer Sales Contests	Where participating dealers are invited to compete in terms of the sales performance.	To increase sales, buyer dealers' loyalty, motivate dealers' staff to sell more.
10	Discounts	Other than normal trade and cash discounts.	To push more sales to trade, early cash recovery.
11	Trade Allowances	These are temporary price reductions/reimbursements of expenses incurred by dealers, in full or in part,	

		its varied types are as under;	
	a. Trade or Buying Allowance	Offer of price reduction on purchase of specified quantity of a product	To load the trade
	b. Buy-Back allowance	A secondary incentive which offers a certain sum of money to trade for each additional unit brought over and above the deal.	To encourage trade cooperation and stimulate repurchase.
	c. Count and Re-count allowance	When a specific amount of money is offered after ascertaining the number of units sold during a specified period.	To move stocks faster, reward on sale only.
	d. Merchandise (display) Allowance	An allowance to trade for providing desired sales promotion and product displays.	To create enthusiasm in trade, improve traffic and exposure at the point-of-purchase, gain larger space/effort of the trade in the promotion of sponsor's product of against the competitor's.
	e. Cooperative advertising and promotion allowance	Wherein a manufacturer shares at an agreed rate the advertising and promotional cost incurred by the dealer in the promotion of manufacturer's product.	To gain product and retail identity, motivate dealers to promote manufacturer's product, obtain local advertising and promotion.
12	Dealer Gifts	Offer of useful articles and attractive gifts to dealers for their personal, family or office use.	To improve dealer relations, make impact on consume scheme/contest offered.
13	Premium or Push Money	When an additional compensation is offered to trade or sales force for pushing additionally a specific product or product line.	To push a specific product or product line.
14	Merchandise Deals	Where additional quantity of the same, same manufacturer's product is	To load dealers with inventory, expose other products of the sponsor

		offered to trade may be offered jointly by non-competing manufacturers.	encouraging dealers to sell more and early to realize their incentive.
15	Point-of-Purchase (POP)	Those special displays, racks, banners, exhibits, that are placed in the retail store to support the sale of brand.	To attract traffic at retail store, remind customers, encourage impulse buying additional visibility to the advertising campaign.

**Source: Donald W. Cowell's article on Sales Promotion and the Marketing of Local Government Recreation and Leisure Services, European Journal of Marketing, 18.2.**

Though ideal for consumer goods, sales promotion is also used for promoting industrial goods. The difference in the use lies in the types of schemes offered, and in the frequency of their offer. Sales promotion schemes offered to industrial customers, besides the usual gifts, price-off coupons and contests, include product demonstration, training to customer staff, offer of interest-free installment payment plan, ready and regular availability of repairs and spares, and posting of trained staff to assist/supervise in the working of the equipment in the client's premises, at the manufacturer's cost. The sales promotion schemes offered at the level of industrial distributors are: provision of extended credit and provision of specialized sales/technical staff at the manufacturer's cost, besides the usual cooperative advertising and sales promotion, gifts, and organisation of distributors' contests. The sales promotion schemes popularly used to motivate the industrial sales force are: prizes and awards on special achievements, sales contests, new accounts contests and prompt service awards.

### 3.6 Towards a Promotional Strategy

After gaining an understanding of the concepts, issues and decision areas relating to four methods of promotion – advertising, publicity, personal selling and sales promotion, let us recall the need for determining the promotion mix (discussed earlier and make few observations concerning the formulation of a promotional strategy. You would recall that promotion constitutes one of the important elements of the marketing mix of a firm. Each firm has a need to perform its promotion (marketing communication) function effectively. Further, each of the four promotion methods has its own unique place in the marketing communications mix of a firm. The question facing marketers, therefore, is not which promotion method to use to meet today's complex marketing tasks. Rather, the real question is which promotion method should be emphasised, how intensively it should be used, and how it can be integrated with the other promotional methods.

Decisions on determination of the promotion mix take us back to the promotion objectives which must emanate from marketing objectives of the firm. A promotional

strategy aims at accomplishing the promotion objectives in the allocated funds and within a scheduled period of time.

Promotional objectives, generally speaking, relate to sales and the marketing communication tasks required to be performed as per the needs of the product market scenario. Expressed in specific measurable terms, these can be put as: increasing sales, improving market share, creating product awareness and comprehension, developing a positive attitude of the public towards the product, building a favourable image of the product, or gaining competitive advantage.

In this context, Leonard M. Lodish suggests 'vaguely right' criteria, the relevant part of which is as follows:

Promotion Decision Area	Vaguely Right Criteria for Evaluation
Advertising Budget	Changes in buyer behaviour – long-term or short-term – and its resulting profitability.
Media Planning Promotion Management	Changes in buyer behaviour per dollar, changes in buyer behaviour and resulting long and short-term profits.
Trade Promotion Management Consumer Coupons	Changes in buyer behaviour of the ultimate consumer, sales and profit changes (both short and long-term) caused by the coupons.

The extent of emphasis to be placed on the different promotion methods is determined by several variables. First, it is dependent on the promotional objectives, and next, on the characteristics of the target public, their psychology, and the allocated funds. For example, a marketer of consumer durables in a metropolitan city like Lagos may use different means like advertising to create awareness and build comprehension. It would also require publicity which could be through press release on the contest technology backing his product. Sales promotion through demonstration, P.O.P. and offer of introductory price to encourage intentions would also be used and, definitely, personal selling to overcome objections, offer conviction and precipitate purchase action would complete the promotion picture.

Further, as revealed by Kenneth G. Nardy, for achieving the objectives of, for example, loading the consumer with larger supplies, it can be seen that it is required that all the methods of promotion be approached simultaneously in terms of objectives to be

achieved. Attaining synergistic advantage arising out of the use of different promotional methods is the hallmark of an effective promotional strategy.

## **4.0 CONCLUSION**

Promotion is an important marketing function of each firm. And rare will be a firm which makes use of only one promotional method. The commonality in the ultimate goal of all the promotional methods apart, their limited suitability in influencing only a specific part of the consumer adoption process calls for the need to use the promotional mix in an integrative manner. Given the complexities in the management of the promotion function and its vulnerability to failure, it is desired that the function be managed professionally. In this unit, we discussed the nature, role, types and the planning process involved in the personal selling and sales promotion methods as promotional tools.

## **5.0 SUMMARY**

In this unit, we discussed the nature, role, types and the planning process involved in personal selling and sales promotion methods of promotion. Personal selling is a direct person-to-person selling and promotion method. The specific role and goals of personal selling vary from firm to firm depending upon the nature of goods marketed, distribution system used, and the sales strategy adopted by a firm. The changing market environment calls upon the sales force to transform it in order to perform a more creative role.

Sales promotion, of late, has emerged as one of the more popular methods of promotion in the case of consumer goods, stated simply, sales promotion deals with offering something extra as an incentive to motivate an early purchase. Sales promotions can be offered at the level of the consumer, trade and sales force. Sales promotions aid in achieving both the push-pull elements of a promotion strategy. Sales promotion schemes used to attain consumer pull include free samples, price-offs premium giveaways, coupons and contests. Schemes offered for gaining the push cover promotional allowances, gifts, discounts, cooperative promotions, contests and awards and rewards. To save a sales promotion programme from getting misfired, it should be planned and managed in a systematic manner.

## **6.0 TUTOR-MARKED ASSIGNMENT**

- i. Everybody (both trained and untrained) partakes in sales jobs nowadays. List and explain 5 types of sales jobs.
- ii. Selling is a professionalized field; hence, there are processes that one should follow in order to achieve sales objectives. Briefly explain the first five 5 processes.

## **7.0 REFERENCES/FURTHER READING**

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## **MODULE 3**

Unit 13; Sources of Information

Unit 14; Elements of an Information System

Unit 15; Ratio Analysis

Unit 16; Budgeting and Break-Even Analysis

Unit 17; Break-Even Chart

### **UNIT 13: BREAK-EVEN CHART**

#### **CONTENT**

1.0 Introduction

2.0 Objectives

3.0 Main Content

    3.1 Meaning of Break-Even Chart

    3.2 Construction of a Break-Even Chart

    3.3 Types of Break-Even Chart

    3.4 Method of Preparation of Break-Even Chart

    3.5 Advantages of Break-Even Chart

    3.6 Limitations of Break-Even Chart

    3.7 Multi-Product of Break-Even Chart

4.0 Conclusion

5.0 Summary

6.0 Tutor-marked Assignment

7.0 References/Further Reading

#### **1.0 Introduction**

In this unit, we are going to discuss the concept of Break-Even Chart. We will be discussing the meaning, the construction of this chart, the types, method of preparation, advantages and limitations and lastly the multi-products of the break-even chart.

#### **2.0 Objectives**

At the end of this unit, students will be able to;

- Understand the meaning of Break-Even chart

- Know the types and how to construct and prepare the Break-Even chart
- Identify the advantages and limitations of the break-even chart
- Know the Multi-products of the Break-Even chart

### 3.0 Main Content

#### 3.1 Meaning of Break-Even Chart

The Break-Even Chart is a graphical representation between cost, volume and profits. No doubt, it is an important tool which helps to make profit planning. It has been defined as, “**a chart which shows the profitability or otherwise of an undertaking at various levels of activity and as a result indicates the point at which neither profit nor loss is made.**”

Since it shows the effects of cost and revenue at varying level of sales it has been rightly called Cost-Volume-Profit graph (CVP graph).

#### BEC depicts the following information:

- Cost (i.e. Fixed, Variable and Total);
- Sales value and Profit/Loss;
- Break-Even Point;
- Margin of Safety.

#### Certain Assumption about the CVP Graph:

- Fixed Cost, will remain constant during the relevant period;
- Semi-Variable Cost can be bifurcated into variable and fixed components.
- Variable cost per unit also will not make any change during the relevant period.
- Selling price also will not make any change during the relevant period irrespective of the quantity sold.
- Operating efficiency also will remain constant.
- Product mix will remain unchangeable.

(g) Volume of production and sales are equal.

### **3.2 Construction of a Break-Even Chart:**

A Break-Even Chart is constructed on a graph paper Activity or volume of production is plotted on the 'X' axis whereas, cost and revenue are plotted on the 'Y' axis.

**Again, 'X' axis may be represented in the following manner, such as:**

(1) Volume in units;

(ii) Sales value;

(iii) Standard Hours; and

(iv) Percentage level of activity.

**The following illustration will help to understand the whole principal:**

Units	Fixed Costs	Variable Cost	Total Cost	Sales
	Rs.	Rs.	Rs.	Rs.
—	40,000	—	40,000	—
1,250	40,000	5,000	45,000	25,000
3,750	40,000	15,000	55,000	75,000
5,000	40,000	20,000	60,000	1,00,000

**Source; Jeswani (2017)**

### **3.3 Types of Break-Even Chart:**

The BECs we have discussed so far are the common type. There are certain types of Break-Even Charts which are yet to be discussed and which are used for various purposes.

**Some of them are discussed here under:**

(a) Detailed Break-Even Chart;

(b) Control Break-Even Chart;

(c) Cash Break-Even Chart; and

(d) BEC to ascertain the optimum volume.

(a) Detailed Break-Even Chart:

Under this type of BEC, the total variable costs, i.e. direct materials, direct labour, variable overhead are represented in this graph together with the appropriation items, like dividend on equity shares, dividend on preference shares, income-tax and retentions are plotted. In this respect it may be mentioned that if this chart contains only the details of appropriation of profit it may be called profit-appropriations BEC.

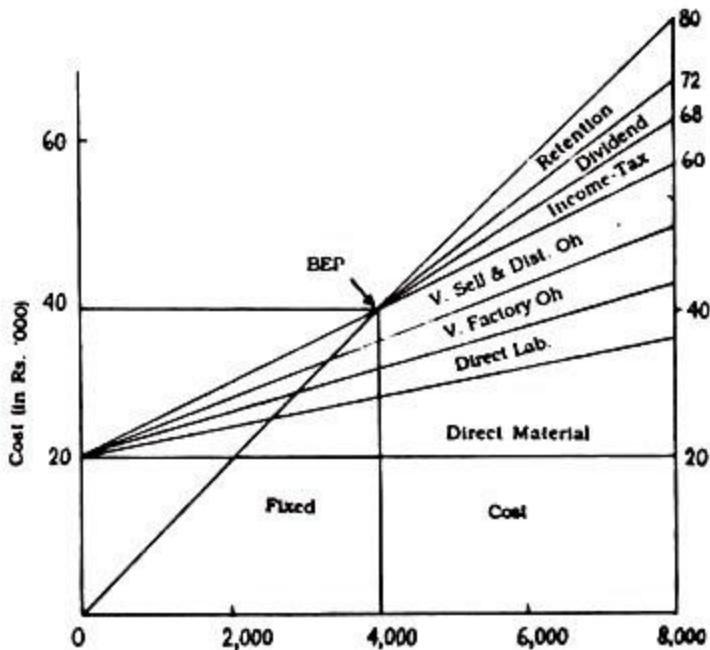
The following illustration will help to understand the principle:

**Illustration:**

**From the following particulars, draw up a detailed BEC:**

<b>Total Fixed Cost</b>	<b>Rs. 10,000</b>
<b>Dividend</b>	<b>Rs. 4,000</b>
<b>Income-Tax</b>	<b>@ 40% of profit</b>
<b>Maximum Sales</b>	<b>8,000 unit @ Rs. 20</b>
<b>Cost Structure</b>	<b>Rs. (per unit)</b>
<b>Direct Material .</b>	<b>4</b>
<b>Direct Labour</b>	<b>2</b>
<b>Variable : Factory Overhead</b>	<b>2</b>
<b>Selling Distribution</b>	<b>2</b>
<b>TC</b>	<b><u>10</u></b>

**Source; Jeswani (2017)**



*Fig. 4.7. Detailed Break-Even Chart*

Source; Jeswani (2017)

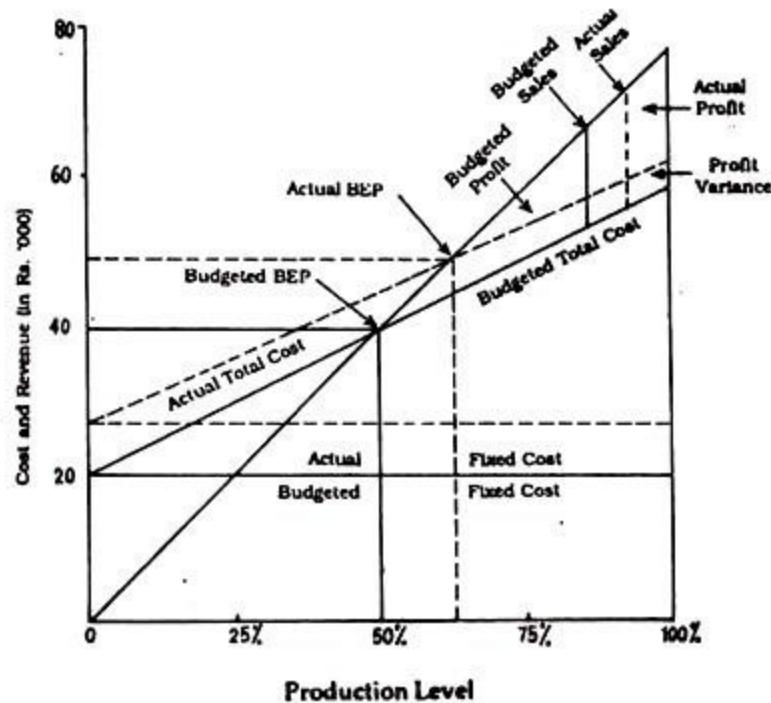
**(b) Control Break-Even Chart:**

Control Break-Even Chart is prepared in order to make a comparison between budgeted/standard and actual cost, sales and profits, particularly when the Budgetary Control Systems and Marginal Costing system are combined, after analyzing the deviations between budgeted/standard and actual figures.

Control Break-Even Chart proves itself a very useful method which directly helps the management in taking decisions. It is to be remembered that the detailed information about deviations between budgeted figures and actual figures is not possible graphically.

**(c) Cash Break-Even Chart:**

Before preparing a Cash Break-Even Chart we are to divide the amount of fixed cost into two following groups:



**Fig. 4.8 Control Break-Even Chart.**

Source; Jeswani (2017)

Viz:

- (i) Fixed Cost which require cost outlay (like, Rent, Salary etc.);
- (ii) Fixed Cost which do not require immediate cost (like, deferred expenditure, Depreciation etc.).

In this chart, item

- (i) Is treated as base like ordinary BEP whereas item
- (ii) Is shown last i.e., after variable cost, so that a comparison can be made easily.

Similarly variable costs which need immediate payment, are plotted as usual. But care should be taken if any credit transaction is included in the variable cost.

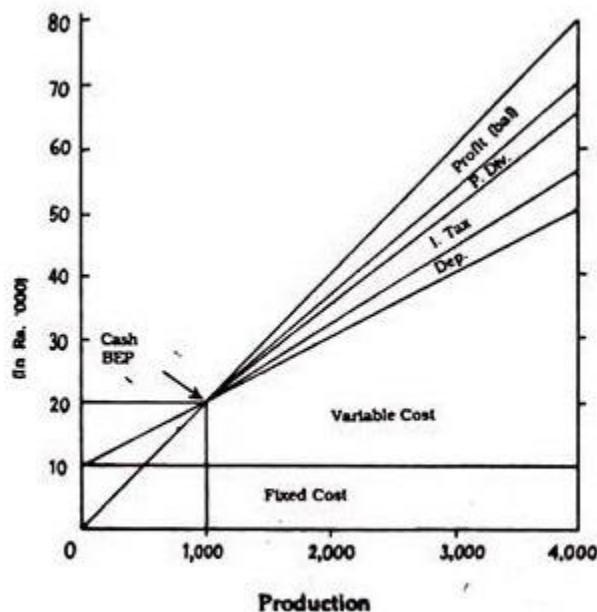
If that be so the' same is to be treated as no. (ii) stated above. This Chart is very useful to those firms which suffer from short-term liquidity and solvency position as well. It is primarily used in cash flow analysis.

**Illustration:**

From the following information prepare a Cash-Break-Even Chart:

	Rs.
<b>Fixed Cost :</b>	
For immediate Cash Payment	10,000
Non-Cash item (Depreciation)	6,000
Variable Cost	10 per unit
Sales 4,000 units	@ 20 per unit
Tax @ 50%	
Pref. Dividend	Rs. 4,000

**Solution:**



*Fig. 4.9 Cash Break-Even Chart.*

Source; Jeswani (2017)

**(d) BEC to ascertain the Optimum Volume:**

This is particularly useful where the demand for a product is elastic. Because in case of perfect competition selling price of a product is to be reduced in order to earn more profit

by increasing the volume of sales which ultimately gives a highest contribution. Now, the problem arises before us is that at what stage the amount of profit will be maximised since the volume of sales are fluctuating.

This can be solved with the help of a BEC which is shown below. In this regard, it may be said that if amount of sales and costs at different stages are plotted on a graph paper, it becomes possible for us to know at which point the profit will be maximized. Needless to mention that, that point will be the optimum level and that selling price of the products will be the optimum selling price of the products of the firm.

All these information can be had with the help of a BEC which is presented below:

**Illustration:**

X Ltd. gives you the following particulars for which you are requested to ascertain the volume of sales and selling price at which the company can maximise profits with the help of a graph.

Expected Sales	Selling price (per unit)
	Rs.
1,000	20
2,000	19
3,000	18
4,000	17
5,000	16
6,000	15
6,500	14

Expected Sales	Selling price (per unit)
	Rs.
7,000	13
7,500	12
8,000	11

**Source; Jeswani (2017)**

The fixed costs amount to Rs. 24,000 and the same is to increase by Rs. 8,000 if the output exceeds 4,000 units.

**Solution:**

**Before preparing the graph the following table is prepared:**

Unit	Sales	Fixed Cost	Variable Cost	Total Cost
	Rs.	Rs.	Rs.	Rs
1,000	20,000	24,000	5,000	29,000
2,000	38,000	24,000	10,000	34,000
3,000	54,000	24,000	15,000	39,000
4,000	68,000	24,000	20,000	44,000
5,000	80,000	32,000	25,000	57,000
6,000	90,000	32,000	30,000	62,000
6,500	91,000	32,000	32,000	64,500
7,000	91,000	32,000	35,000	67,000
7,500	90,000	32,000	37,500	69,500
8,000	88,000	32,000	40,000	72,000

Now taking the above data, we can plot the same on a graph which is depicted as under:

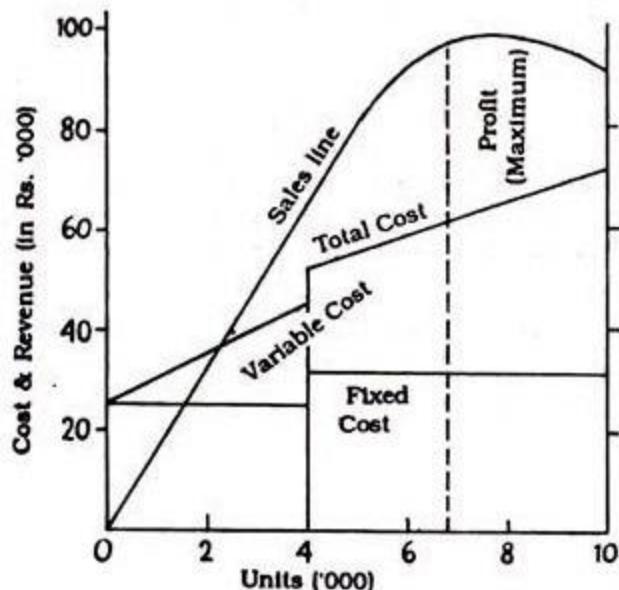


Fig. 4.10. Showing Optimum Volume.

Source; Jeswani (2017)

From the above, it becomes clear that at 6,500 units, the profit can be maximized. In other words, at this level the sales value/line is higher than the total cost line resulting in the highest margin. As such, this will be the optimum level of output at the prevailing selling price which will yield the maximum profit.

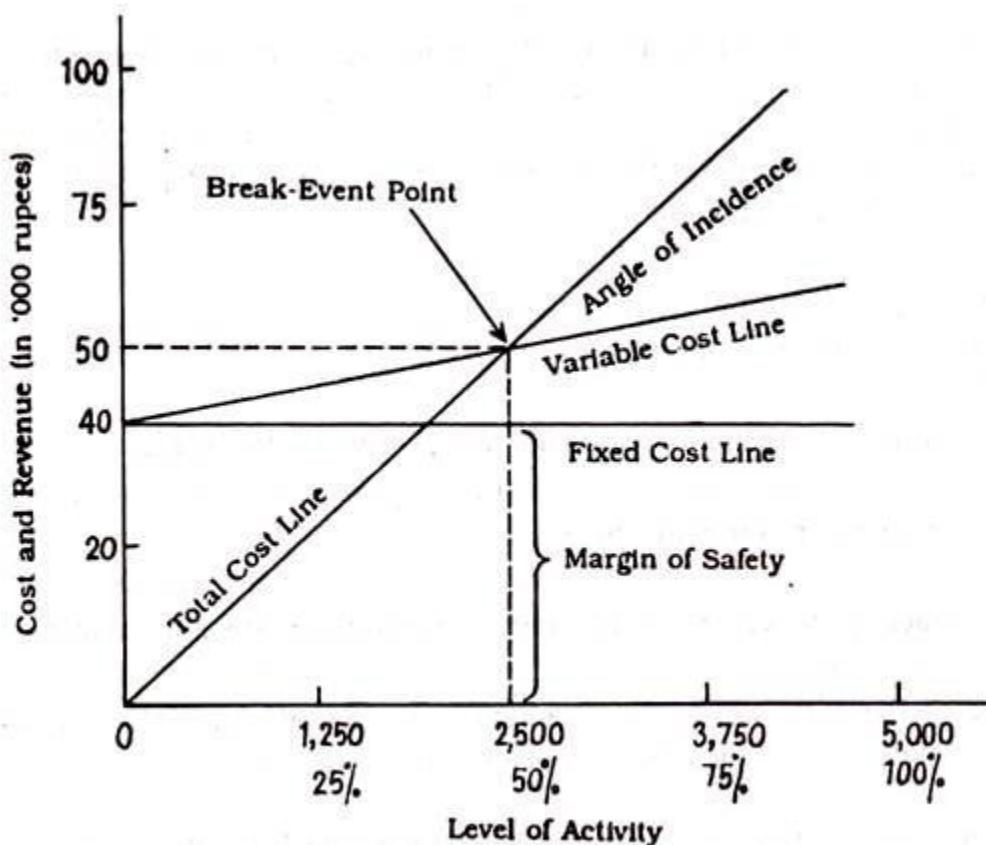
### 3.4 Method of Preparation of Break-Even Chart:

(a) Draw fixed Cost of Rs 40,000 line parallel to 'X' axis. Then plot the variable cost line over fixed cost level at various level of activity and join the variable cost line with fixed cost line at zero level of activity which will indicate total cost line — variable cost being over fixed cost line.

(b) At the same time, ascertain sales value at various activity level and plot them on the graph paper and then to zero which line indicates the volume of sales.

(c) It is interesting to note that where the sales line intersects the total cost line, that is known as Break-Even point. Needless to mention here that BEP will be ascertained by drawing a perpendicular to 'X' axis from the point of intersection which measures the horizontal distance from the zero point from where the perpendicular is drawn.

Similarly, in order to find out BES value, another perpendicular to the 'Y' axis from the point of intersection is drawn.



**Fig 4.2 Break-Even Chart.**

**Source; Jeswani (2017)**

**Comments:**

From the above BEC, it becomes clear that profit/loss at different levels of activity can be understood from this chart. For example, if we find the sales line is above the total cost line, there will be profit and vice-versa. Similarly, if total cost is equal to total sales, there

is no profit or no loss i.e., break-even point. In Fig. 4.2 diagram, 50% level of activity brings break-even level.

### **3.5. Advantages of Break-Even Chart:**

**The following advantages may be offered by a BEC:**

**(i) Easy to Construct and Easy to Understand:**

A Break-Even Chart gives us very clear-cut information which helps the management to take correct decisions as it depicts a detailed picture of the entire undertaking.

**(ii) Useful Tool to Help Management:**

It has already been pointed out that a BEC gives us the relationship between Cost, Volume and Profit. Thus, the same may present the effect of changes in cost and selling price due to the change in variable cost and fixed cost.

**(iii) Helps to Select the most Profitable Product Mix:**

No doubt a BEC helps us to select the most profitable product mix or sales mix for earning more profits.

**(iv) Helps to Ascertain the Strength of the Business:**

This chart helps us to determine profit earning capacity after analysing together Angle of incidence and Margin of Safety.

**Therefore, the Management obtains some important information relating to:**

(i) Increase the selling price,

(ii) To reduce the cost;

(iii) To substitute the less profitable product by more profitable products, and

(iv) To increase the volume of productio

### **3.6. Limitations of Break-Even Chart:**

**The BEC is not free from snags. They are:**

**(i) Based on Unrealistic Assumptions some of them are:**

- (a) Selling price remains constant irrespective of the volume of sales;
- (b) Production and sales are equal (i.e., without considering value of stock);
- (c) Variable cost remains same;
- (d) All indirect cost can be segregated into fixed and variable. In actual practice, however, all the above assumptions are not correct

**(ii) Ignore the Concept and Effect of Capital Employed:**

BEC ignores the basic accounting elements i.e., capital employed which is very significant for calculating the rate of profitability or earnings,

**(iii) Construction of Multiple BEC Chart:**

If different variety of products are produced, separate BEC should be drawn up which creates a problem of fixed overhead allocation.

**3.7. Multi-Product of Break-Even Chart:**

It is quite possible to produce different types of products for a firm and in that case, a Multi-product Break-Even Chart may be constructed for the firm as a whole. Naturally, in that case, BEP will be that point where the Average contribution line will intersect the fixed cost line assuming that there will be no change in sales-mix.

**Method of Construction of Multi- Product Break-Even Chart:**

- (a) Complete P/V ratio and arrange the products in descending order according to P/V ratios.
- (b) Y axis represents contribution and fixed cost while X axis represents sales value;
- (c) Then plot the total fixed cost line;
- (d) And then take the product which has highest P/V ratio, plot its contribution against sales and so on;
- (e) Now, get the average contribution line after joining the origin to the end of the last line so plotted.

(f) The BEP will be that point where average contribution will cut fixed cost line of the products.

**Illustration:**

X Ltd products three types of products, viz. A, B and C.

**Construct a BEC in order to determine their BEP from the following particulars:**

	Total Rs.	A Rs.	B Rs.	C Rs.
Sales	50,000	20,000	12,500	17,500
Fixed Cost	9,250	—	—	—
Variable Cost	31,500	10,000	7,500	14,000

**Solution:**

Before constructing the BEC, let us calculate the P/V ratio of each product first. Then according to the importance of P/V ratio, a table showing cumulative sales should also be prepared. At last, complete the graph.

$$P/V \text{ Ratio} = \frac{C}{S}$$

∴ For Products :

$$A = \frac{Rs. 20,000 - Rs. 10,000}{Rs. 20,000} = \frac{Rs. 10,000}{Rs. 20,000} = \frac{1}{2} \text{ or } 50\%$$

$$B = \frac{Rs. 12,500 - Rs. 7,500}{Rs. 12,500} = \frac{Rs. 5,000}{Rs. 12,500} = \frac{2}{5} \text{ or } 40\%$$

$$C = \frac{Rs. 17,500 - Rs. 14,000}{Rs. 17,500} = \frac{Rs. 10,000}{Rs. 17,500} = \frac{1}{5} \text{ or } 20\%$$

Now we are to prepare the following table:

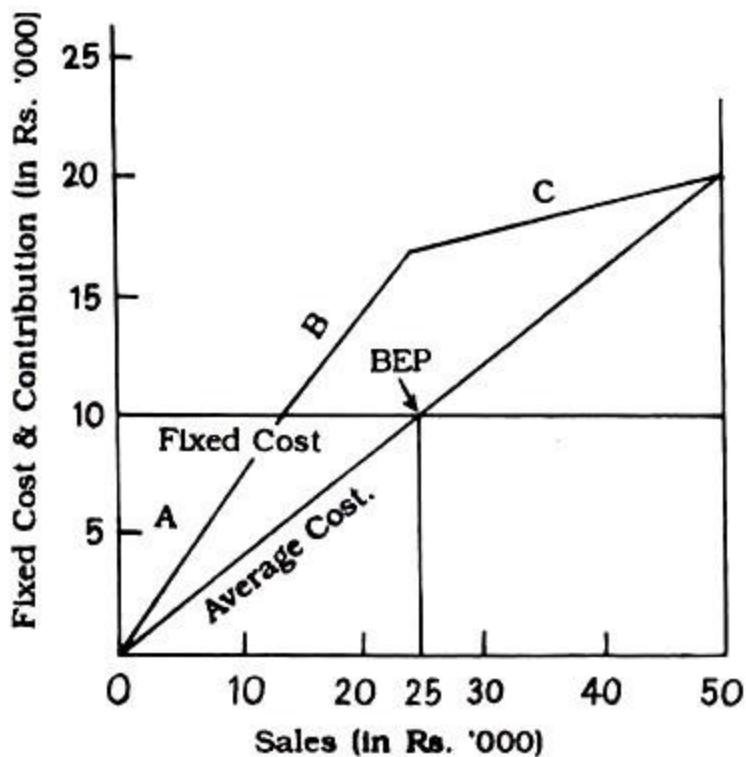
Product	P/V Ratio	Sales		Contribution	
		Product wise	Cumulative	Product wise	Cumulative
A	50%	20,000	20,000	10,000	10,000
B	40%	12,500	32,500	5,000	15,000
C	20%	17,500	50,000	3,500	18,500

$$\begin{aligned} \therefore \text{BES will be} &= \frac{\text{Fixed Cost}}{\text{Total Contribution}} \times \text{Total Sales} \\ &= \frac{Rs. 9,250}{Rs. 18,500} \times Rs. 50,000 \\ &= Rs. 25,000 \end{aligned}$$

Source; Jeswani (2017)

The same result can also be depicted by the following Multi-Product Break-Even Chart

(BEC) as under:



**Fig. 4.6 Multi-Product BEC**

Source; Jeswani (2017)

#### 4.0 Conclusion

At the end of this unit, we were able to discuss the concept of Break-Even Chart. We also discussed the meaning, the construction of this chart, the types, method of preparation, advantages and limitations and lastly the multi-products of the break-even chart.

#### 5.0 Summary

#### 6.0 Tutor-marked Assignment

#### 7.0 References/Further Reading

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## **UNIT 14: SOURCES OF INFORMATION**

### **CONTENT**

1.0 Introduction

2.0 Objectives

3.0 Main Content

    3.1 Source of Information

    3.2 Strategic Importance of Information

    3.3 Characteristics and costs of useful information

    3.4 Internal Source of Information

    3.5 External Source of Information

4.0 Conclusion

5.0 Summary

6.0 Tutor-Marked Assignment

7.0 References/Further Reading

### **1.0 Introduction**

In this unit, we are going to discuss sources of information, the strategic importance of information, characteristics and costs of useful information, and internal and external information.

### **2.0 Objectives**

At the end of this unit, students will be able to;

- Understand the meaning of Sources of Information
- Know the strategic importance of information
- Explain the characteristics and costs of useful information
- Identify Internal and External sources of Information

### **3.0 Main Content**

#### **3.1 Source of Information**

A generation ago, computer hardware and software had little to do with managing business information. Rather than storing information on hard drives, managers stored it in filing cabinets. Instead of uploading daily sales and inventory levels by satellite to corporate headquarters, they mailed hard-copy summaries to headquarters at the end of each month. Today, a generation later, computer hardware and software are an integral part of managing business information. In larger part, this is due to something called Moore's law. Moore predicted that every 18 months, the cost of computing would drop by 50 percent as computer-processing power doubled. We begin this unit by explaining why information matters.

Raw data are basically facts and figures. Facts and figures are not particularly useful unless they have meaning. If you can't interpret any form of data presented to you, then the data is useless. Whereas raw data consist of facts and figures, Information is useful data that can influence someone's choices and behavior.

### **3.2 Strategic Importance of Information**

In today's hypercompetitive business environments, information, whether its about real estate, product inventory, pricing or costs, is as important as capital for business success. It takes money to get businesses started, but businesses can't survive and grow without the right information. Information has strategic importance for organizations because it can be used;

- a. To obtain first-mover advantage; First-mover advantage is the strategic advantage that companies earn by being the first to use new information technology to substantially lower costs or to make a product or service different from that of competitors.
- b. To sustain a competitive advantage once it has been created; companies that use information technology to establish first-mover advantage usually have higher market shares and profits. However, sustaining a competitive advantage through information technology is not easy to do.as technologies that created first-mover advantage mature, they get easier, cheaper, and more reliable. When this happens, competitors adopt those technologies and can erase the advantage that firs-movers created for themselves. The key to using information technology to continuously improve and support the core functions of a business.

### **3.3 Characteristics and costs of useful information**

Information is useful when it is;

- Accurate; Information is useful when it is accurate. Before relying on information to make decisions, you must know that the information is correct.
- Complete; Information is useful when it is complete. Incomplete or missing information makes it difficult to recognize problems and identify potential solutions.
- Relevant; You can have accurate, complete information, but if it doesn't pertain to the problems you are facing, then its irrelevant and not very useful.
- Timely; Finally, information is useful when it is timely. To be timely, the information must be available when needed to define a problem or to begin to identify possible solutions.

Costs of useful information;

- Acquisition costs; this is the cost of obtaining data that you don't have.
- Processing costs; this is the cost of turning raw data into usable information

- Storage cost; the cost of physically or electronically archiving information for later use and retrieval.
- Communication costs; this is the cost of transmitting information from one place to another.

### 3.4 Internal Source of Information

Internal information consists of data created for the sole use of the company that produces it, such as personal files, trade secrets etc. There are different types of internal information such as financial, personnel, marketing, sales, manufacturing and administration. Internal information sources can be defined as follows;

- **Financial information:** this information is related to the performance and profit and loss of the company. This will include information on how much you pay for items, how much you pay for staff, the costs of rates and the taxes that you pay as a business. To monitor the financial information you need to have a financial controller or accountants to ensure that the business continues to operate and generate a profit.
- **Personnel Information:** Personnel information is information held by the company on their employees. This information must be freely available to the employee any time that they request it. Personnel information can be used to monitor how long an employee has worked for a company and if they are entitled to a salary increase due to this based on the company policy. Other information may be held such as the productivity rate of an employee and a bonus might be given based on performance and targets. It is important that the company has up to date information on all employees for health and safety reasons. Companies also need to get proof of qualifications from employees to ensure they are suitably qualified for a certain position on entry to the company. The employee can progress within the company after their information is updated with any internal or external training programs that relate to their job.
- **Marketing Information:** Marketing information is used by the market team to identify what products or services offered by the business are most successful. The marketing team can collect information from different departments such as sales to promote certain products or services based on current success rates. Marketing information can be obtained using external sources or by using surveys to see what customers like or dislike about your product or service. This information can be used to streamline or improve your business and keep customers happy.
- **Purchasing Information:** Purchasing information is collected by the purchasing department who are involved with buying all the products needed to run your business. These products could be stationary or computers need for the day to day running of your business or multi-million dollar parts used in your manufacturing process. The purchasing department needs to monitor the cost and quality of all

purchased goods to ensure they get the best deal and maximize profits for the company.

- **Sales Information:** Just like the purchasing information sales information needs to be monitored based on the product or services offered by your company. This information needs to be passed to the financial controllers of your companies to ensure that the cost of your good or service is less than the sale price. If the sale of a certain product is down then this information would need to be passed to the marketing team to see if it is worth launching a new marketing campaign to increase sales of the product.
- **Manufacturing information:** This is information about the cost of manufacturing goods within the company. The manufacturing cost will normally include the running cost of all machinery, the wages paid to production staff and the cost of raw materials (including waste) used up in the manufacturing process. An example of monitoring manufacturing costs would be for a company that mass produces furniture such as IKEA they would need to ensure that they create cut patterns to ensure that they got as many parts as possible from a single 8 foot by 4-foot piece of ply would. If they decreased the amount of waste cut by 10% this could save the company millions over a few years.
- **Administration Information:** Administration information links very much with personnel information but also involves communicating with external sources and storing information on customers to build successful relationships with them.

### 3.5 External Source of Information

External information is whereby documentation is made available to the public from a third party. As well as internal sources of information companies can also use external sources to help them make the correct business decisions. Examples of external information sources are: Government, trade groupings, commercially provided information, database and research. If a company uses external sources of information then they must be sure of the reliability of the data sources. Here are some examples of how the company could use information supplies by external sources.

- **Government:** Information supplied by the government is coming from a reliable source as this is the governing body that they business operates within. Companies need to use important legal information from the Government to help run the business successfully and legally. For example, if a company had over 1,000 employees that were being paid the minimum hourly rate as outlined by the Government and the rate changes then the company needs to take this information on board and increase the wages for the staff on this wage range. Another example would be if the Government offered businesses grants for opening manufacturing

plants in areas of high unemployment a company might use this information to their advantage to set up a new plant at a lower cost than in another area.

- **Trade Groupings:** A trade grouping is a group of businesses that operate within the same sector and not within the same location. For example, tech companies would be part of the Technical Trade Association and Farmers might be part of the Farming Association within a country or region. As a business being a member of a trade grouping enables you to access information that helps you run your business successfully. For example, solicitors are part of the legal trade and will have memberships that give them access to the latest laws that they must use to support their clients in the best possible way.
- **Commercially Provided:** Companies can use commercially provided information to help them make the correct business decisions. These decisions are made based on information made available to them from other companies. For example, a hotel group might use the information about the number of flights to and from several airports along with the information on the number of hotels beside each airport to make a decision on where to open their newest hotel. A games development company might decide on what platform to create a game for based on the number of units sold for each hardware platform. For example, if Apple released sales figures for the iPhone 5 and they were much less than Samsung's Galaxy SIII then the company would probably target to release their latest game for the Samsung phone first.
- **Databases & Research:** Companies can research information that might help them increase the sales and level of interest in their business. The key thing to researching information that helps run your business is to ensure it is accurate and reliable. Some companies will pay to access commercially available databases that offer a range of information directly based on their business sector. Many companies can make money creating this information by analyzing currently available sales stats business sectors. When using any external information source, it is essential to be sure about the reliability of the data sources and sometimes it is worth paying to access relevant information.

## 4.0 Conclusion

At the end of this unit, we discussed the meaning of sources of information, its strategic importance, characteristics and costs. Furthermore, we defined internal and external source of information and discussed its examples.

## 5.0 Summary

- Raw data are basically facts and figures. Facts and figures are not particularly useful unless they have meaning. If you can't interpret any form of data presented

to you, then the data is useless. Whereas raw data consist of facts and figures, Information is useful data that can influence someone's choices and behavior.

- Information has strategic importance for organizations because it can be used; to obtain first-mover advantage and; to sustain a competitive advantage once it has been created.
- Information is useful when it is accurate, timely, relevant and complete.
- Internal information consists of data created for the sole use of the company that produces it, such as personal files, trade secrets etc.
- External information is whereby documentation is made available to the public from a third party.

## **6.0 Tutor-Marked Assignment**

- a. Define External and Internal Source of Information and also discuss their different types.

## **7.0 References/Further Reading**

Williams. C. (2005) Management. Thomson South-Western. ISBN 0-324-20126-5

# **UNIT 15: ELEMENTS OF AN INFORMATION SYSTEM**

## **CONTENT**

1.0 Introduction

2.0 Objectives

3.0 Main Content

    3.1 Definition and Elements of Information System

        3.1.1 Components of Information System

    3.2 Records retention programme

        3.2.1 Concept of Records

- 3.2.2 Records management practices
- 3.2.3 Records Management guidelines for Information Technology System
- 3.2.4 Record Management requirements
- 3.2.5 Retention Schedule
  - 3.2.5.1 Scheduling Process
  - 3.2.5.2 Records Retention Committee
- 3.3 Procedures of the Records Retention programme
- 3.4 Uses of Information tools (such as manuals, reports and forms)

4.0 Conclusion

5.0 Summary

6.0 Tutor-marked assignment

7.0 Further-reading/References

## **1.0 Introduction**

In this unit we are going to discuss the concept of Information System and its elements. We will discuss the advantages and procedures of developing records retention programme. We will further highlight how small businesses can use information tools.

## **2.0 Objectives**

At the end of this unit, students will be able to;

- Understand the concept of Information System and its elements
- Know the Records Retention programme
- Explain the procedures of a records retention programme
- Understand the uses of information tools such as manuals, reports and forms.

## **3.0 Main Content**

### **3.1 Definition and Elements of Information System**

Almost all programs in business require students to take a course in something called *information systems*. But what exactly does that term mean? Let's take a look at some of the more popular definitions;

Schneider and Valacich (2010) opined that, “Information systems are combinations of hardware, software, and telecommunications networks that people build and use to collect, create, and distribute useful data, typically in organizational settings.” Also Laudon and Laudon (2012) stated that, “Information systems are interrelated components working together to collect, process, store, and disseminate information to support decision making, coordination, control, analysis, and visualization in an organization.”

As you can see, these definitions focus on two different ways of describing information systems: the *components* that make up an information system and the *role* that those components play in an organization. Let's take a look at each of these.

### **3.1.1 Components of Information systems**

Information System is made up of five components hardware, software, data, people, and process. The first three, fitting under the technology category, are generally what most students think of when asked to define information systems. But the last two, people and process, are really what separate the idea of information systems from more technical fields, such as computer science. In order to fully understand information systems, students must understand how all of these components work together to bring value to an organization.

- i. Technology;** Technology can be thought of as the application of scientific knowledge for practical purposes. From the invention of the wheel to the harnessing of electricity for artificial lighting, technology is a part of our lives in so many ways that we tend to take it for granted. As discussed before, the first three components of information systems – hardware, software, and data – all fall under the category of technology. Each of these will get its own chapter and a much lengthier discussion, but we will take a moment here to introduce them so we can get a full understanding of what an information system is.
- ii. Hardware**  
Information systems hardware is the part of an information system you can touch – the physical components of the technology. Computers, keyboards, disk drives, iPads, and flash drives are all examples of information systems hardware.
- iii. Software**  
Software is a set of instructions that tells the hardware what to do. Software is not tangible – it cannot be touched. When programmers create software programs, what they are really doing is simply typing out lists of instructions that tell the hardware what to do. There are several categories of software, with the two main categories being operating-system software, which makes the hardware usable, and application software, which does something useful. Examples of operating systems include Microsoft Windows on a personal computer and Google's Android on a mobile phone. Examples of application software are Microsoft Excel and Angry Birds.
- iv. Data**  
The third component is data. You can think of data as a collection of facts. For example, your street address, the city you live in, and your phone number are all

pieces of data. Like software, data is also intangible. By themselves, pieces of data are not really very useful. But aggregated, indexed, and organized together into a database, data can become a powerful tool for businesses. In fact, all of the definitions presented at the beginning of this chapter focused on how information systems manage data. Organizations collect all kinds of data and use it to make decisions. These decisions can then be analyzed as to their effectiveness and the organization can be improved.

### **3.2 Records retention programme**

**Records management**, also known as **records and information management**, is an organizational function devoted to the management of information in an organization throughout its [life cycle](#), from the time of creation or inscription to its eventual disposition. This includes identifying, classifying, storing, securing, retrieving, tracking and destroying or permanently preserving records.

An organization's records preserve aspects of institutional memory. In determining how long to retain records, their capacity for re-use is important. Many are kept as evidence of activities, transactions, and decisions. Others document what happened and why. The purpose of records management is part of an organization's broader function of Governance, risk management, and compliance and is primarily concerned with managing the evidence of an organization's activities as well as the reduction or mitigation of risk associated with it.

#### **3.2.1 Concepts of Record**

The concept of **record** is variously defined. The ISO 15489-1:2016 defines the concepts and principles from which approaches to the creation, capture and management of records are developed. While there are many purposes of and benefits to records management, as both these definitions highlight, a key feature of records is their ability to serve as evidence of an event. Proper records management can help preserve this feature of records.

Recent and comprehensive studies have defined records as "persistent representations of activities" as recorded or created by participants or observers. This transactional view emphasizes the importance of context and process in the determination and meaning of records. In contrast, previous definitions have emphasized the evidential and informational properties of records. In organizational contexts, records are materials created or received by an organization in the transaction of business, or in pursuit of or in compliance with legal obligations. This organizational definition of record stems from the early theorization of archives as organic aggregations of records, which is "the written documents, drawings and printed matter, officially received or produced by an administrative body or one of its officials."

#### **3.2.2 Records management practices.**

A Records Manager is someone who is responsible for records management in an organization. This part of ISO 15489 (2016) describes concepts and principles relating to the following:

- a) Records, metadata for records and records systems;
- b) Policies, assigned responsibilities, monitoring and training supporting the effective management of records;
- c) Recurrent analysis of business context and the identification of records requirements;
- d) Records controls;
- e) Processes for creating, capturing and managing records.

Thus, the practice of records management may involve:

- planning the information needs of an organization
- identifying information requiring capture
- creating, approving, and enforcing policies and practices regarding records, including their organization and disposal
- developing a records storage plan, which includes the short and long-term housing of physical records and digital information
- identifying, classifying, and storing records
- Coordinating access to records internally and outside of the organization, balancing the requirements of business confidentiality, data privacy, and public access.
- identification and maintenance of records per a specified retention period
- Executing a retention policy on the disposal of records which are no longer required for operational reasons; according to organizational policies, statutory requirements, and other regulations this may involve either their destruction or permanent preservation in an archive.

Records-management principles and automated records-management systems aid in the capture, classification, and ongoing management of records throughout their lifecycle. Such a system may be paper-based (such as index cards as used in a library), or may involve a computer system, such as an electronic records-management application.

### **3.2.3 Records Management Guidelines for Information Technology Systems**

For information technology systems, there are two general categories of records: those records that are associated with the actual creation, maintenance and retirement of the information technology system itself and those records that comprise the data content of the system. Each of these sets of records must be managed in concert with the other. The records management requirements for the data content of the system are the same as if the records were kept in a non-electronic medium with the additional requirement that technologies must be maintained that enable the records to be accessible, accurate,

authentic, reliable, legible, and readable throughout the life of the data record. Records required for the creation and maintenance of the information technology system itself include implementation project documents such as procurement proposals and system support documentation. The records management requirements and retention schedules will likely vary between these two categories of records.

### **3.2.4 Records management requirements**

Functional requirements are grouped according to the clusters in the high-level model:

- a. Create-** Capture, Identification, Classification
- b.** Maintain; Controls and Security; Hybrid records; Retention, migration and disposal; Long-term preservation
- c.** Disseminate; Search, retrieve and render
- d.** Administer; Administrative functions

**3.2.5 Retention schedules;** A retention schedule is a document listing all the titles of the records series, length of time each document or record will be retained as an active record, the reason for its retention (administrative, legal, fiscal, and historical) and disposition agreed by the user, receiver, and Records Director and Records Retention committee. A clearly defined plan for a record retention and disposal is a vital component of a records program.

#### **3.2.5.1The Scheduling Process**

A retention schedule is a policy document that is created by the Records Director and the department the record is used by (owner). It is reviewed typically once a year to verify that the current retention decisions should remain in effect. The following is the information is on the retention schedule:

- Record series names
- Series description
- Retention period (based on material date)
- Disposition methods
- Approval dates for each series

Once the Department Head, Liaison, and the Records Director have reached agreement on the retention schedule for all stored material, the retention schedule is verified and signed by both parties.

#### **3.2.5.2Records Retention Committee**

The purpose for the Records Retention Committee is to provide guidance for the Records Director for establishing and operating a retention and disposition program as a component for records management program covering:

- Periods of time for records to be maintained
- Appropriate methods for disposition of records
- Measures to be taken when a record disposition must be suspended due to litigation or audit

### **3.3 Procedures in developing records retention programme**

- a. Establish a records management team to develop and implement a strategic plan for the program and to provide a governance structure.**
  - Assign team responsibilities and authorities:
    - An integrated records management steering committee consisting of an executive program sponsor (senior vice president or chief executive officer who reports to the board) and key stakeholders from records management, legal, information technology, compliance and other key business groups, will meet regularly to provide program governance, strategic guidance and support.
    - The records management staff has responsibility for developing, implementing and maintaining the program.
  - A network of records coordinators will serve as the liaisons between the records management staff and the departments in your organization.
  - Identify drivers for developing a records management program, and define a strategic plan, goals and objectives that provide your program focus and high visibility and assists in determining the resources needed to support the program.
  - Develop mission and vision statements in alignment with the strategic plan of your organization. The vision statement describes where you want to see the records management program two or three years down the road and the mission statement describes the purpose of the program, services offered, whom the program serves and guides your program towards achieving its vision. These statements will help you prioritize projects and develop an implementation plan based on the resources available.
  - Obtain senior management support for the establishment and continual management of a records management program.
  - Determine what services will be done “in-house” and what services will be done by outside vendors and consultants.
- b. Conduct an organization-wide inventory of the records in your office.**
  - The records inventory identifies what information your organization has to manage, including physical and electronic, and is essential to a good records and information management program. The inventory is the groundwork for which you will develop your program's records retention schedule in step four below. The inventory will help you identify which materials your organization considers:

- Records (recorded information created or received by your organization in pursuance of legal obligations or in the transaction of business and has value requiring its retention)
- Non-records (reference materials, personal papers, junk mail, publications, convenience file, duplicate copies)
- Vital records (records which would be needed immediately after an emergency to continue your organization's operation)
- Archival records (historical records of enduring value that are preserved and stored in your organization's archives)
- Once you have identified all the departments in your organization and begin to get a feel for the scope of records to be inventoried, you will need to consider whether you have the resources to conduct the project or if you should hire a consultant to conduct the inventory.
- You can conduct the inventory via physical inventory, surveys, interviews or a combination of these methods. I think it is important to interview record coordinators from each department to identify and review document repositories and any systems used to create information and process transactions. Department document repositories could include network file shares, SharePoint, employee computers and file cabinets. While conducting department interviews, you should also check for closets and any unoccupied offices that may be holding stored records.
- The inventory should include whether records exist in more than one format, media, software and physical location of records.
- Review organizational repositories checking for records that are stored in:
  - Email and other messaging or collaboration servers
  - Enterprise-wide SharePoint deployments
  - Enterprise content management systems
  - Electronic records management systems
  - Back-up servers
  - On-site centralized records centers
  - Off-site storage areas for physical and/or electronic records
- Once a draft list of documents for each department is prepared, it should be reviewed with the department to make sure no records were overlooked.
- While conducting the inventory, create a log of all repositories in your organization. This will assist in the event of discovery. Your legal counsel will be aware of all responsive systems and repositories.

**c. Establish your organization's records management policies and procedures.**

- The records management policy serves as the basis for the entire program, is your program's primary governance instrument and provides employees guidance. The policy should be endorsed at the highest decision-making level, publicized throughout your organization and made readily available to all staff.

- Developing your records management policy will be dependent on your organization's culture. Your policy should include:
  - Defining records management responsibilities assigned to employees of your organization to include the executive sponsor, steering committee, records management and information technology staff, business unit managers, system administrators, record coordinators and general users.
  - Definition of a “record.”
  - Whether records will be kept in a centralized area, decentralized within work areas or a combination of both.
  - Records retention and disposition procedures to include: how draft documents and working papers will be handled, who will be responsible for maintaining the official record copy and litigation hold procedures.
- The records management procedures should describe in detail how to comply with the requirements outlined in the records policy and other instruments. It provides records management processes for the records staff, recordkeeping processes for the records coordinators and end users and, when applicable, specific procedures for business units.

**d. Develop a records retention program.**

- A records retention program consists of a method for determining retention periods, a records retention schedule and retention policies and procedures. This ensures your organization's records are kept as long as required to meet regulatory, legal and business requirements; that records are not destroyed too early or retained too long; and that your organization follows systematic retention and defensible records destruction practices.
- The retention schedule provides your organization's functional groups retention and disposition instructions for related records based on regulatory, legal and business requirements. Establishing a retention schedule is the single most important thing you can do to guarantee the success of your organization's overall records management program. A retention schedule is the foundation of a records management program and applies to records in any format, i.e., paper, electronic (disk, CD, database, email, etc.). All other components of a records management program rely on the records retention schedule that facilitates your organization's legal compliance, efficiency and risk management.
- The retention schedule should be tailored to your organization's needs ensuring all records essential to your organization are retained only as long as needed based on documented research of legal, fiscal, administrative and historical requirements. Retaining records longer may increase organizational liability.

**e. Implement a records management training program.**

- All staff, contractors and records coordinators need to be trained and know their records management responsibilities. This can be accomplished via a combination of vehicles:
  - Records management intranet site

- New employee, records coordinator, business unit/department training
- Handouts
- Regular all-employee announcements related to records management policies and procedures

### **3.4 Advantages of developing a retention programme**

- 1. Protect your company or organization from liability;** If your records become the subject of litigation, an established retention schedule can protect your company. Records which are disposed of following the published retention guidelines would rarely, if ever, be questioned in legal proceedings or third-party review.
- 2. Demonstrate your compliance with legal requirements.;** Establishing a retention policy requires each record series to be considered on its own, and a time frame to be created, indicating how long a particular record series should be maintained. A written policy demonstrates that your organization is following established, legal procedures when destroying and retiring documents.
- 3. Improve records management efficiency/consistency;** Implementing a corporate-wide retention schedule will require the records manager to identify all of the organization's record series. This process will provide the opportunity to identify and eliminate duplicated documentation and redundant records. This process will make the records management program more efficient and less costly.
- 4. More efficient use of expensive office space;** A well implemented record retention schedule can identify records which are eligible for destruction as well as records which can be sent to less expensive, offsite storage. The return on investment from destroying unneeded records and transferring semi-active and inactive records to offsite storage can produce immediate and significant cost savings.

Implementation of a comprehensive record retention schedule will reduce costs, improve efficiency, and may assist in avoiding legal liability. With a reduced volume of records, identifying and retrieving important documents will be easier when they are needed. Be sure to have your legal counsel or corporate attorney review the schedule before it becomes official policy within your organization.

## **4.0 Conclusion**

In this unit, we discussed the concept of Information System and its elements. We also discussed the advantages and procedures of developing records retention programme. We also further highlighted how small businesses can use information tools.

## 5.0 Summary

For information technology systems, there are two general categories of records: those records that are associated with the actual creation, maintenance and retirement of the information technology system itself and those records that comprise the data content of the system. Each of these sets of records must be managed in concert with the other. The records management requirements for the data content of the system are the same as if the records were kept in a non-electronic medium with the additional requirement that technologies must be maintained that enable the records to be accessible, accurate, authentic, reliable, legible, and readable throughout the life of the data record. Records required for the creation and maintenance of the information technology system itself include implementation project documents such as procurement proposals and system support documentation. The records management requirements and retention schedules will likely vary between these two categories of records.

## 6.0 Tutor-marked assignment

- a) State the advantages of developing a retention programme
- b) Procedures in developing records retention programme

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## **UNIT 16: RATIO ANALYSIS**

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### **1.0 Introduction**

In this unit, we are going to discuss Financial Ration Analysis. We will expatiate on the nature of financial ratios, the sources of data analyzed, its purposes and types.

### **2.0 Objectives**

At the end of this unit, students would be able to;

- Define Financial Ratios
- Know its purposes
- Identify and discuss the various types

### **3.0 Main Content**

#### **3.1 Definition of Financial Ratios**

Financial ratios are mathematical comparisons of financial statement accounts or categories. These relationships between the financial statement accounts help investors, creditors, and internal company management understand how well a business is performing and of areas needing improvement.

Financial ratios are the most common and widespread tools used to analyze a business' financial standing. Ratios are easy to understand and simple to compute. They can also be used to compare different companies in different industries. Since a ratio is simply a mathematically comparison based on proportions, big and small companies can be use ratios to compare their financial information. In a sense, financial ratios don't take into consideration the size of a company or the industry. Ratios are just a raw computation of financial position and performance.

### **3.2 Sources of Data**

Values used in calculating financial ratios are taken from the balance sheet, income statement, statement of cash flows or (sometimes) the statement of changes in equity. These comprise the firm's "accounting statements" or financial statements. The statements' data is based on the accounting method and accounting standards used by the organisation

### **3.3 Purposes**

Financial ratios quantify many aspects of a business and are an integral part of the financial statement analysis. Financial ratios are categorized according to the financial aspect of the business which the ratio measures.

Financial ratios allow for comparisons

- between companies
- between industries
- between different time periods for one company
- between a single company and its industry average

### **What Ratios Should Be Calculated?**

There are any number of ratios you could calculate. When trying to decide which ratios to work on, there are some standard ones that most business firms use. The problem with ratios is that they are useless unless they are compared to something. For example, if you calculate your firm's debt ratio for one time period (let's say a year) and it's 50%. What does that really mean? All you can take from that is a debt ratio that shows total liabilities/total assets, and that 50% of your firm's assets are financed by debt. You don't know if that is good or bad unless you have something to compare.

## **Trend Analysis**

Presumably, you have other years of balance sheet data for your small business. It is very helpful if you calculate the financial ratios for several years (or quarters if you have that data) so you can track the trends in your ratio. You can compare your firm's ratios to trend data. To complete this comparison, you want to take data from the past ( e.g. same time last year), and compare it to the present to see how your firm is doing over a series of time periods.

## **Industry Analysis**

Just as important as trend analysis is industry analysis. It's very important, particularly in today's economic climate, to know what your industry is doing as compared to your company. For example, if your industry's ratios are much different than your firms, you want to examine why and perhaps take action. You can also compare your firm's ratios to industry data. You can gather data from similar firms in the same industry, calculate their financial ratios, and see how your firm is doing in comparison to the industry at large. Ideally, to get a good financial picture of your firm, you should do both.

### **3.4 Types of Financial Ratios**

Financial ratios can be broadly classified into liquidity ratios, solvency ratios, profitability ratios and efficiency ratios (also called activity ratios or asset utilization ratios). Other categories include cash flow ratios, market valuation ratios, coverage ratios, etc.

#### **Liquidity Ratios**

Liquidity ratios assess a business's liquidity, i.e. its ability to convert its assets to cash and pay off its obligations without any significant difficulty (i.e. delay or loss of value). Liquidity ratios are particularly useful for suppliers, employees, banks, etc. Important liquidity ratios are:

- Current ratio
- Quick ratio (also called acid-test ratio)
- Cash ratio
- Cash conversion cycle

#### **Solvency Ratios**

Solvency ratios assess the long-term financial viability of a business i.e. its ability to pay off its long-term obligations such as bank loans, bonds payable, etc. Information about solvency is critical for banks, employees, owners, bond holders, institutional investors, government, etc. Key solvency ratios are:

- Debt ratio
- Debt to equity ratio
- Debt to capital ratio
- Times interest earned ratio
- Fixed charge coverage ratio
- Equity multiplier

## **Profitability Ratios**

Profitability ratios measure the ability of a business to earn profit for its owners. While liquidity ratios and solvency ratios explain the financial position of a business, profitability ratios and efficiency ratios communicate the financial performance of a business. Important profitability ratios include:

- net profit margin
- gross profit margin
- operating profit margin
- return on assets
- return on capital employed
- return on equity
- earnings per share

Other ratios related to profitability that are used by investors to assess the stock market performance of a business include:

- price to earnings (P/E) ratio
- price to book (P/B) ratio
- Dividend payout ratio
- Dividend yield ratio
- Retention ratio

## **Activity Ratios**

Activity ratios assess the efficiency of operations of a business. For example, these ratios attempt to find out how effectively the business is converting inventories into sales and sales into cash, or how it is utilizing its fixed assets and working capital, etc. Key activity ratios are:

- inventory turnover ratio
- days sales in inventory
- receivables turnover ratio
- days sales outstanding
- payables turnover ratio
- days payable outstanding
- fixed asset turnover ratio
- working capital turnover ratio

## **Cash flow ratios**

Cash flow ratios are mainly used to assess the quality of earnings of a business. Since net income information is based on accrual concept, which is subject to significant management judgment, cash flows ratios (also called performance ratios) provide a more unbiased assessment. Examples include cash flow per share.

## **Coverage Ratios**

Coverage ratios are supplementary to solvency and liquidity ratios and measure the risk inherent in lending to the business in long-term. They include EBIDTA coverage ratio, debt coverage ratio, interest coverage ratio (also known as times interest earned), fixed charge coverage ratio, etc.

## **4.0 Conclusion**

In this unit, we discussed the definition of financial ratios, the sources of data used, purpose and types of financial ratios. We are going to discuss Financial Ratio Analysis. We will elaborate on the nature of financial ratios, the sources of data analyzed, its purposes and types.

## **5.0 Summary**

Financial ratios are mathematical comparisons of financial statement accounts or categories. These relationships between the financial statement accounts help investors, creditors, and internal company management understand how well a business is performing and of areas needing improvement.

The statement of cash flows is a relatively new financial statement in comparison to the income statement or the balance sheet

The income statement has some limitations since it reflects accounting principles. For example, a company's depreciation expense is based on the cost of the assets it has acquired and is using in its business. The resulting depreciation expense may not be a good indicator of the economic value of the asset being used up.

Financial ratios can be broadly classified into liquidity ratios, solvency ratios, profitability ratios and efficiency ratios (also called activity ratios or asset utilization ratios). Other categories include cash flow ratios, market valuation ratios, coverage ratios, etc.

## **6.0 Tutor-Marked Assignment**

- iii. Highlight the differences between Cash flow ratios and Coverage ratios

## **7.0 References/Further Reading**

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# **UNIT 17: BUDGETING AND BREAK EVEN ANALYSIS**

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## **1.0 INTRODUCTION**

The need to efficiently and effectively manage a business is not in doubt, and such management requires coordination and control of the total business efforts to achieve the business goals. The process of managing is facilitated when management charts its course of action in anticipation of the future events. Budgeting is thus, a systematic approach for achieving management performance. It is an integral part of management.

It is noteworthy to mention that a budget is more than a financial instrument, for it relates to quantities of product and to operations, and consequently serves as a complete programme of business activities in the period to which it relates. Budgeting is thus, the planning of the conduct of a business.

It defines the absolute annual expenditures in terms of the naira, men, time etc., which will be permitted by a functional unit, with a possible refinement showing monthly breakdowns in those cases where costs are not expected to be constant throughout the budget period.

## **2.0 OBJECTIVES**

At the end of this unit, you will be able to:

- define budget
- explain the purpose of budgeting
- types of budgetary system
- discuss break-even analysis

## **3.0 MAIN CONTENT**

### **3.1 Budgeting in Business**

A Budget is a comprehensive and coordinated plan, expressed in financial terms, for the operations and resources of an enterprise for some specified period in the future. It is the plan of the business expectations in the future usually for twelve months. It should be noted that an overall organization budget for one fiscal year with each department in the organization submitting her inputs to aid a comprehensive budget, Besides, the department later breakdown into weekly or monthly their budgets depending on the nature and size of business.

According to the Institute of Chartered Marketing Association (ICMA), England, a "budget is a financial and quantitative statement, prepared and approved prior to a defined period of time of the policy to be pursued during a given period for the purpose of attaining a given objective. e.g. profit or sales volume". The budget provides a guidepost to point the way, and the actual steering of the vehicle is in the hands of the driver-manager.

Planning involves the control and manipulation of relevant variables, and reduces the impact of uncertainty and risk. A budget &presses the plan in formal terms and helps to realize the firm's expectations. A budget is thus, a mechanism to plan for the organization's overall operations. The most important aspects of every operation are: revenues and expenses.

The budget must plan for quantity revenues and expenses related to a specific operation. Planning should not only be done for revenue and expenses, but must include planning for assets and the sources and uses of funds.

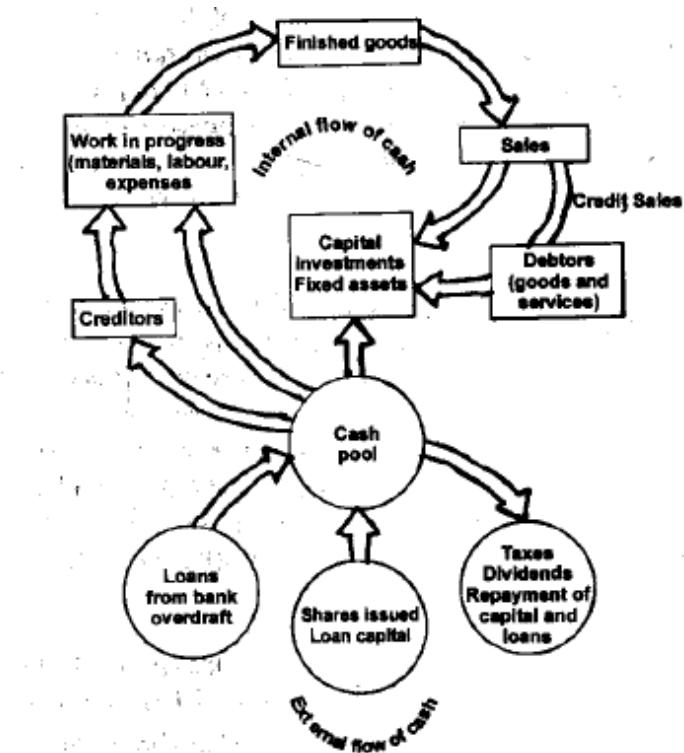
The sources and uses of funds statements shows the new wealth that has become available to a business in the year and how it has been invested in the organization. They can be constructed to highlight changes in the firm's cash position, as they tend to emphasize different aspects of management of finance. The major sources of funds include:

- Cash introduced by owner(s)
- Available loan to business
- Sale of assets
- Income from operations

The uses of funds are in the areas of:

- i Owner's withdrawals
- ii Loan repayments
- iii. Purchase of assets
- iv. Losses from operations

v. Payments to tax authorities



The success of a budget depends greatly on the control instruments or mechanisms put in place, hence, the need for budgetary control. Budgetary control is a system which uses budget as a means of planning and controlling, defined as the establishment of budgets relating to the responsibilities of executive to the required policy and the continuing comparison of actual with the budgeted results, either to secure by individual or collective action of the objective of that policy, or to provide basis for revision.

The realization of an organization's goals in terms of comprehensive profit planning and controlling or budgeting is a systematic and formalized approach for stating and communicating the firm's expectations and accomplishing the planning, coordination, and control responsibilities of management in such a way as to maximize the use of given resources all rest on effective budgetary control system. It is a management technique.

### 3.2 Purposes of budgeting

The main reasons for budgeting are:

1. To state a firm's expectation categorically and unambiguously to avoid possible confusion and facilitate their attainability. With this, individuals are motivated and performance can be evaluated. A number of both endogenous and exogenous variables affects such expectations, such as, socio-economic factors, political

factors, supply and demand conditions, competitive environment, technological dynamism etc.

2. It is used to reduce inherent risks and uncertainty that characterizes every business and to ensure proper direction of individual and group efforts to achieve goals. This is the impact of planning.
3. To provide a parameter to measure and control the performance of individuals and units in the organization and recommend corrective steps that will guarantee the achievement of the organization's goal. It serves as a feed-back mechanism.
4. To provide a means to effectively communicate organizational expectation to all parties involved in managing the business. A clear and written communication of objectives through budgets will help employees to understand, support and accomplish goals.
5. To help employees in coordinating resources and projects. This entails the harmonization of the activities of all departments for the realization of the organization's common goal.

### **3.3 Budget Preparation**

The preparation of a comprehensive budget will include:

- a. Sales budget
- b. a production budget
- c. a purchasing budget
- d. labour budget
- e. cash budget.

The illustration given below is used to demonstrate what the preparation of budget is like.

#### **Illustration**

Ajons and Co. Ltd. is contemplating the preparation of budget for May, June, and July. It sells its two products in three different sales areas. The company's balance sheet for the year just ended is shown in Table 1 below Sales areas A, B and C respectively produce 10 percent, 20 per cent and 70 per cent of product X sales and 50 per cent, 30 per cent, and 20 per cent of product Y sales. The selling price for product X is ₦ 10 and ₦14 for product Y.

Sales are made on 50 per cent cash and 50 per cent credit basis. The credit sales are collected in the following month.

**Table 1**

<b>Ajons &amp; Co. Ltd</b>		
<b>Balance Sheet, 31st December, 1999</b>		
	<b>₦</b>	<b>₦</b>
Creditors for December purchases		12,300
Dividend payable (due on Jan. Y2K)		3,000
Share Capital		<u>2,91,210</u>
Total		<u>3,06,510</u>
Cash		12,000
Debtors (for December Sales)		15,000
Stock:	15,750	
Raw materials (15,750 at N1 each)	5,760	
Product X(720 at N8)	<u>18,000</u>	39,510
Product Y (1800 at N10)	3,00,000	
	<u>60,000</u>	<u>2,40,000</u>
Plant and Machinery		<u>3,06,510</u>
Less: Accumulated depreciation		
<b>Total</b>		

Finished goods are valued at the cost of direct labour and direct materials. Sales for December 1999 were N30,000. The monthly forecast of sales (units) are:

<b>Units</b>	<b>May</b>	<b>June</b>	<b>July</b>	<b>August</b>
X	900	1,050	1,200	1,350
Y	2,250	2,400	2,550	2,70

The production of products X and Y uses one common material which costs N1 per unit. Two units of material are required to produce one unit of product X while product Y requires four units of the same material. Wages are paid at the rate of N6 per hour during which it can produce one unit of X or Y. Ajons & Co. Ltd has a policy of maintaining a basic finished products inventory equal to 80 per cent of next month's sales and a raw material inventory equal to 150 per cent of current month's production needs.

The payments to creditors are made during the month of the following purchase. Salaries and wages are paid during the month they accrue. Sales commission is 5 per cent of sales and is paid during the month earned. An equipment costing ₦1,500 will be purchased in June and the payment will be made in the same month. A minimum cash balance of

₦12,000 at the end of each month is intended to be maintained by Ajons & Co. Ltd. Money can be borrowed or repaid in multiples of ₦3,000. Interest rate on loans is 6 per cent per year. Loans are initiated on the first day of the month, and repaid on the last day of the month. Interest is paid when the principal is repaid.

The following are other estimated monthly expenses:

Salaries	₦1,500	paid as incurred
Rent	₦600	paid as incurred
Depreciation	₦1,800	
Miscellaneous	1% of Sales	paid as incurred.

### **Note**

(The above illustration shall be used as we progress on the types/classifications of budgetary system).

## **3.4 Types of Budgetary System**

The size of an average business organization determines the type of budgetary system to be adopted. Most businesses are too large to permit the detailed planning of the total business in a single budget. It is thus necessary to use a master budget that encompasses all the plans and shows how they affect the business as a whole. With this details being left for various specialized budgets. The following are the major types or classifications of budgets:

### **3.4.1 Sales Budget**

It forms the fundamental basis on which all other budgets are based. In most organizations, it is the starting point of the budgeting plan; therefore, it is the level of sales that determine the budgeting plan in the organization. As sales are the primary source of cash receipts, such sales estimates is the foundation of financial planning.

It can be asserted that a budget is a forecast of sales to be achieved in a budget period, as production cost is based on all activities, most of which again depends on predicted sales level. The sales prediction is the foundation for the qualification of the entire business plan.

In preparing sales budget, the following must be taken into consideration:

- i yearly break-down
- ii product break-down
- iii. territory break-down
- iv. past sales experience
- v. sales-man estimate
- vi. plant capacity
- vii. pricing policy and strategy
- viii. government control
- ix. competition
- x. political situation.

**Table 2**

<b>Ajons &amp; Co. Ltd.</b>				
<b>Area and products</b>	<b>Months</b>			
	<b>May</b>	<b>June</b>	<b>July</b>	<b>Total</b>
	<b>N</b>	<b>N</b>	<b>N</b>	<b>N</b>
<b>Sales Area A</b>				
Product X	900	1,050	1,200	3,150
Product Y	<u>15.750</u>	<u>16.800</u>	<u>17.850</u>	<u>50.400</u>
<b>Total</b>	<u>16.650</u>	<u>17.850</u>	<u>19.050</u>	<u>53.550</u>
<b>Sales Area B</b>				
Product X	1,800	2,100	2,400	6,300
Product Y	<u>9.450</u>	<u>10.080</u>	<u>10.710</u>	<u>30.240</u>
<b>Total</b>	<u>11.250</u>	<u>12.180</u>	<u>13.110</u>	<u>36.540</u>
<b>Sales Area C</b>				
Product X	6,300	7,350	8,400	22,050
Product Y	<u>6.300</u>	<u>6.720</u>	<u>7.140</u>	<u>20.160</u>
<b>Total</b>	<u>12.600</u>	<u>14.070</u>	<u>15.540</u>	<u>42.210</u>
Total of all assets	<u>40.500</u>	<u>45.100</u>	<u>47.700</u>	<u>33.300</u>

### **Limitations**

1. Plant capacity may not be enough
2. Non-availability of required personnel
3. Non-availability of the needed raw materials
4. Inadequate capital
5. Since sales is mostly on credit the cash position is a determinant factor.

#### **3.4.2 Cash Budget**

It represents the cash requirement of the business during a budget period and attempt to compare the estimated cash receipt and cash disbursement of the company over the budget period and is designed to show the periodical cash balancing position. Cash balance must be kept at optimum level, that is, too little cash can lead to illiquidity or insolvency, whereas, too much cash tends to affect profitability negatively.

It is a special type of budget which reveal the happenings or the likelihood of how other sub-budgets succeed in view of the levels of cash in the organization. Hence, it relates to other budgets because all other plans has to be tested and reviewed in relation to how they affect the cash position.

**Table 3**

	<b>Months</b>		
	<b>May</b>	<b>June</b>	<b>July</b>
	<b>N</b>	<b>N</b>	<b>N</b>
Beginning cash balance	12,000	13,080	13,944
Add. Cash Collections:			
50% of sales	20,250	22,050	23,850
Collection from debtors	<u>15,000</u>	<u>20,250</u>	<u>22,050</u>
Total Cash receipts	<u>47,250</u>	<u>55,380</u>	<u>59,844</u>
Less: Cash disbursements			
Raw materials purchases	12,300	13,050	13,770
Salaries	1,500	1,500	1,500
Wages	20,340	22,140	23,940
Sales commission	2,025	2,205	2,385
Rent	600	600	600
Miscellaneous	405	441	477
Purchase of equipment	-	1,500	-
Dividends	3,000	-	-
Total Cash disbursement	<u>40,170</u>	<u>41,436</u>	<u>42,672</u>
Cash surplus or deficit	7,080	13,944	17,172
Minimum Cash balance (ending)	<u>12,000</u>	<u>12,000</u>	<u>12,000</u>
Borrowing (repayment)	6,000	-	(3,000)
Interest	-	-	(45)
Cash balance ending	<u>13,080</u>	<u>13,944</u>	<u>14,127</u>

## Advantages

- a. It ensures sufficient cash position
- b. It reveals shortage or surplus and suggests necessary actions to be taken.
- c. It shows whether or not required expenditure could be internally financed or not
- d. It shows the availability of cash, so that the advantages of cash discount may be exploited.

### 3.4.3 Production Budget

The sales estimate shows the volume of each line of product which is expected to be required, periodically. The production budget is aimed at assuring that finished goods meet the demands of the sales management.

The budget determines the quantity of such goods on hand which must be maintained at the proper size in relation to sales. If the stock on hand is too large, a financial loss may result due to deterioration, changes in style, spoilage, cost of storage, maintenance expenses etc. If the stock becomes too small, there is the fear of losing sales and customers due to non-availability or inadequate supply of goods.

The production budget is prepared after the sales budget as it is based on sales forecast. A meaningful production budget requires the need to combine the sales forecasts for each product with information about the beginning level and the expected level of ending inventories of the finished products.

Budgeted production unit is thus:

Sales estimate + expected ending inventory - Beginning inventory.

**Table 4**

	Months		
	May	June	July
	N	N	N
Estimated sales of X	900	1,050	1,200
+ Desired ending inventory	<u>840</u>	<u>960</u>	<u>1,080</u>
	1,740	2,010	2,280
- Beginning inventory	720	840	960
Units of X to be produced	<u>1,020</u>	<u>1,170</u>	<u>1,320</u>
Estimated sales of Y	2,250	2,400	2,550
+ Desired ending inventory	<u>1,920</u>	<u>2,040</u>	<u>2,160</u>
	4,170	4,440	4,710

- Beginning inventory	<u>1,800</u>	<u>1,920</u>	<u>2,040</u>
Units of Y to be produced	<u>2,370</u>	<u>2,520</u>	<u>2,674</u>

### SELF-ASSESSMENT EXERCISE

- i. What is a budget?
- ii. What are the advantages of cash budget?

#### 3.4.4 Raw Material Budget

Having prepared the production budget, the materials usage and the purchasing budget will have to be estimated and constructed. The raw materials are the items from which the product is made. Their costs are direct or prime costs. The direct cost of working capital which these stocks represent and the indirect burden of deterioration, provision of storage space, maintenance and supervision all must be taking into cognizance.

These problems must be solved along with when, how much and where to buy. The materials budget is a tool that enables the purchasing department to plan and secure materials timely. The material usage depends upon the level of production and the level of beginning inventory and desired ending inventories. The units of material to be purchased are thus, determined as:

Purchases (units) = Budgeted usage + Desired ending inventory (material) - Beginning inventory (material)

**Table 5**

	Months		
	May		
	N	N	N
Material needed to produce X (1 unit of X x 2 units of material)	2,040	2,340	2,640
Material needed to produce Y (1 unit of Y x 4 units of materials)	<u>9,480</u>	<u>10,080</u>	<u>10,680</u>
Total production needed	11,520	12,420	13,320
+ Desired ending balance	<u>17,280</u>	<u>18,630</u>	<u>19,980</u>
Total needs	28,800	31,050	33,300
- Beginning balance	<u>15,750</u>	<u>17,280</u>	<u>18,630</u>
Purchases (units)	<u>13,050</u>	<u>13,770</u>	<u>13,770</u>
Cost of purchases (N)	<u>13,050</u>	<u>13,770</u>	<u>13,770</u>

#### 3.4.5. Labour Budget

A business organization must have adequate work force who must be available whenever their services are required to aid in achieving the realization of the organization's objectives. The problem with the preparation of labour budget is that sometimes labour may be idle (as there may not be work) yet the organization cannot afford to dismiss them, and their presence requires that management provides services like good working environment - canteens, Wash rooms etc.; in order to keep the workforce irrespective of the volume of work done. The budget helps in the comparison of relative costs of productive and idle-time of labour.

A direct labour schedule is presented below from the data given in the production budget; the direct labour hours required to be produced and the labour hours required per unit of output.

**Table 6**

	<b>Months</b>		
	<b>May</b>	<b>June</b>	<b>July</b>
	<b>N</b>	<b>N</b>	<b>N</b>
Units of X to be produced	1,020	1,170	1,320
Units of Y to be produced	<u>2,370</u>	<u>2,520</u>	<u>2,670</u>
Total Units	<u>3,390</u>	<u>3,690</u>	<u>3,990</u>
Total hours at 1 hr per unit	<u>3,390</u>	<u>3,690</u>	<u>3,990</u>
Total labour cost N6, per unit	<u>20,340</u>	<u>22,140</u>	<u>23,940</u>

### **3.4.6 Physical Property Budget**

This is the need to budget for physical properties like building, machinery and equipment that constitute a relatively permanent investment, which though depreciate over time. The proposed programme as based upon the sales estimate may call for the installation of additional equipment.

Anything in form of permanent equipment can be justified only in the light of long term considerations. An increase in demand of permanent nature may justify further installation; but a temporary demand may have to be met by putting out work to sub-contractors during the peak period, or by overtime or double shift working or by the accumulation of stocks in slack period against the time of peak demand.

### **3.4.7 Fixed Budget**

It is a budget designed to remain unchanged regardless of the level of activity actually attained. It is prepared on the basis of standard cost.

However, because of its unrealistic nature, essentially due to changing purchasing power of money, particularly, during inflation, it has suffered the following draw-backs:

- a. it is difficult for management to assess performance at different departmental levels;
- b. it may not conform with actual production level; and
- c. it is often difficult to revise, in case the business condition undergo basic change.

Fixed budget has limited application and also ineffective as a tool for cost control. Many organizations try to give up the concept as it does not provide for automatic adjustment with changing volume. It is however, advantageous as it ensure judicious and prudent disbursement of limited financial resources. It does not encourage extra-budgetary budgeting. There is financial discipline.

#### **3.4.8 Flexible Budget**

It is a budget designed to accommodate changes in the level of activities that is experienced in an organization. It is thus, a more dynamic concept, but its flexibility gives room for easy manipulation and provides for extra-budgetary allocations. It is advantageous in the following ways:

- a) desirable when business (sales) conditions are unpredictable e.g. luxurious goods or new products;
- b) it is necessary for control of operating condition;
- c) it is easily adaptable, elastic and more practical;
- d) it is useful when external factors such as weather variation, exporting activities, new products etc. are common in an economic environment.

Its defects are observed as follows:

- a. it is very costly;
- b. it depends on accuracy of data collected; and
- c. it is incapable of replacing good management.

It can be asserted from the foregoing that every organization has a basket of budgetary systems and uses that which is relevant to it at different times.

The budget is a solution to all problems, hence, those who administer it and those that are influenced directly by it must understand and actively support it to ensure its success.

#### **3.5 Merits of Budgeting**

1. It ensures that management plans for the future, by having the foresight of looking ahead and planning into the future.
2. It results in goal congruency by helping to co-ordinate, integrate and balance all departmental efforts to attain the overall organization's objectives.
3. It jolts the consciousness of a business towards cost implications, financial plans and profitability
4. It boosts the employees morale by posing challenges to them, giving them sense of belonging and allowing their participation in plans formulation and policy recommendations.
5. It measures efficiency and pave way for self-auditing and evaluation.
6. It improves the quality of free flow of communication.
7. It aid in optimizing the use of an organization resources, both human and materials, and channel the efforts of the organization towards the realization of its goals.
8. It facilitates control by providing definite expectations in the planning, phase that can be used as a reference point for judging the subsequent performance.
9. It permits inter-departmental comparisons within an organization periodically.
10. It complements planning efforts.

### **3.6 Demerits of Budgeting**

1. It is very expensive and time consuming
2. It hinders dynamism, innovations and change which is a requisite for the development of any organization
3. It is not an exact science; thus, it is not free of value-judgment, personal biases and subjectivism.
4. Its success is not in its beauty but on proper implementation.
5. It largely depends on accuracy of data supplied and other information provided by the Research and Development department.
6. It will lower morale and productivity if unrealistic targets are set and use as a pressure tactic.
7. It shields inefficiencies rather than revealing them, hence, calls for regular performance evaluation.
8. It should be applied with caution, for it is only one of the management tools, and should not make management complacent.

### **3.7 What is a 'Break-Even Analysis'**

Break-even analysis entails the calculation and examination of the margin of safety for an entity based on the revenues collected and associated costs. Analyzing different price levels relating to various levels of demand, an entity uses break-even analysis to determine what level of sales are needed to cover total fixed costs. A demand-side analysis would give a seller greater insight regarding selling capabilities.

### **3.7.1 Breaking down 'break-even analysis'**

Break-even analysis is useful in the determination of the level of production or in a targeted desired sales mix. The analysis is for management's use only as the metric and calculations are often not required to be disclosed to external sources such as investors, regulators or financial institutions. Break-even analysis looks at the level of fixed costs relative to the profit earned by each additional unit produced and sold. In general, a company with lower fixed costs will have a lower break-even point of sale. For example, a company with \$0 of fixed costs will automatically have broken even upon the sale of the first product assuming variable costs do not exceed sales revenue. However, the accumulation of variable costs will limit the leverage of the company as these expenses are incurred for each item sold.

### **3.7.2 Contribution Margin**

The concept of break-even analysis deals with the contribution margin of a product. The contribution margin is the excess between the selling price of the good and total variable costs. For example, if a product sells for \$100, total fixed costs are \$25 per product and total variable costs are \$60 per product, the product has a contribution margin of the product is \$40 (\$100 - \$60). This \$40 reflects the amount of revenue collected to cover fixed costs and be retained as net profit. Fixed costs are not considered in calculating the contribution margin.

### **3.7.3 Formulas for Break-Even Analysis**

The calculation of break-even analysis may be performed using two formulas. First, the total fixed costs are divided the unit contribution margin. In the example above, assume total company fixed costs are \$20,000. With a contribution margin of \$40, the break-even point is 500 units (\$20,000 divided by \$40). Upon the sale of 500 units, all fixed costs will be paid for, and the company will report a net profit or loss of \$0.

Alternatively, the break-even point in sales dollars is calculated by dividing total fixed costs by the contribution margin ratio. The contribution margin ratio is the contribution margin per unit divided by the sale price. Using the example above, the contribution margin ratio is 40% (\$40 contribution margin per unit divided by \$100 sale price per unit). Therefore, the break-even point in sales dollars is \$50,000 (\$20,000 total fixed costs divided by 40%). This figured may be confirmed as the break-even in units (500) multiplied by the sale price (\$100) equals \$50,000.

## **4.0 CONCLUSION**

It is obvious that no business will survive without profit planning which must be based on certain budget or estimation of both income and expenditure to determine whether or not the business opportunity available is worthwhile.

## **5.0 SUMMARY**

Budgeting plans future activities of a business organization and in this unit we were able to define budget, the purpose of budgeting, how to prepare a budget and types of budgetary systems.

## **6.0 TUTOR MARKED ASSIGNMENT**

1. What are the limitations of sales budget?
2. Define budget
3. State 5 merits of budgeting

## **7.0 REFERENCES/FURTHER READING**

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