GIMMENOTES.CO.ZA

Contibuter's Name

Unknown

Notes Overview

Chapter 13 - 19

Email

info@gimmenotes.co.za

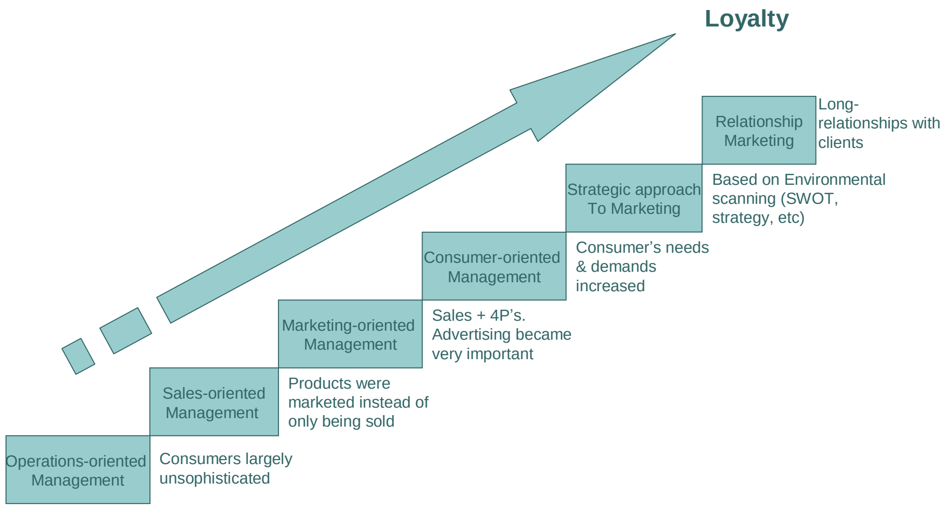
School

University of South Africa (UNISA)

Chapter 13

The Marketing Process

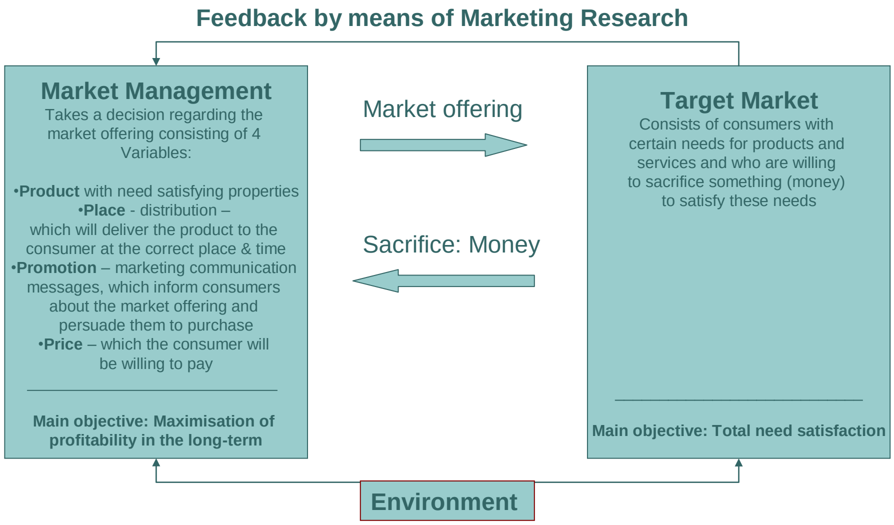
Marketing evolution



What is Marketing?

- Marketing consists of management tasks and decisions directed at successfully meeting opportunities and threats in a dynamic environment, by effectively developing and transferring a need-satisfying market offering to consumers in such a way that the objectives of the business, the consumer and society will be achieved.

Components of Marketing Process



Marketing research

- Marketing research is the systematic gathering, analysis and interpretation of information on all types of marketing problems by utilising recognised scientific methods for the accumulation of information to facilitate marketing management's decision-making
- E.g. Surveys, focus groups, etc.

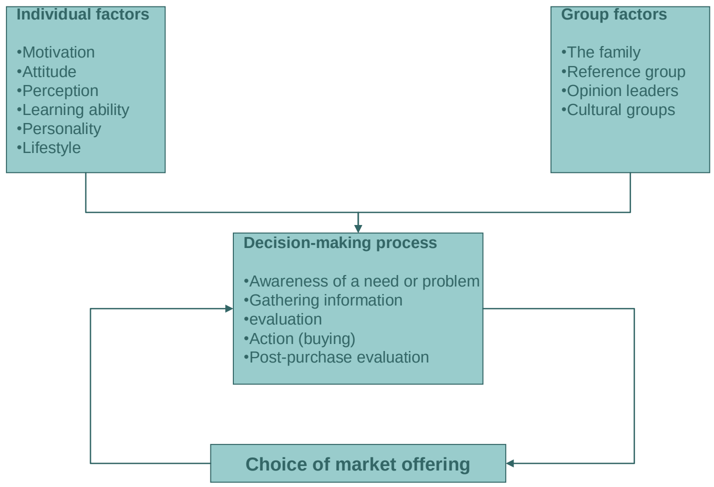
Steps involved in surveys

- Step 1: Definition of the problem to be investigated
- Step 2: Formulation of probable explanations & causes for the defined problem
- Step 3: Investigation of all the hypotheses in order to eliminate the less likely ones and find a solution to the problem
- Step 4: Compilation of questionnaire
- Step 5: Testing the questionnaire
- Step 6: Choosing respondents to whom the questions are to be put
- Step 7: Training of fieldworkers
- Step 8: Processing & analysis of the info contained in the questionnaire
- Step 9: Interpretation of results
- Step 10: Compilation of a research report & the making of recommendations based on the conclusion
- Step 11: Marketing management (& top management) study the report & make decisions
- Implementation of management's decisions

Consumer behaviour

- Consumer behaviour refers to the behaviour patterns of decision-making units (families or individuals) directly involved in the purchase and the use of products, including the decision-making processes preceding & determining these bahaviour patterns

Determinants of consumer behaviour

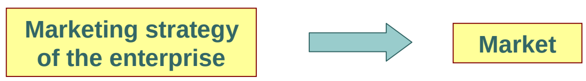


Market segmentation

- Market segmentation means different things to different people. In brief, it consists of a relatively large number of people (or organisations) that:
  - Have a need for a specific product
  - Are able to buy it
  - Are willing to spend money on it
  - Are allowed to do so

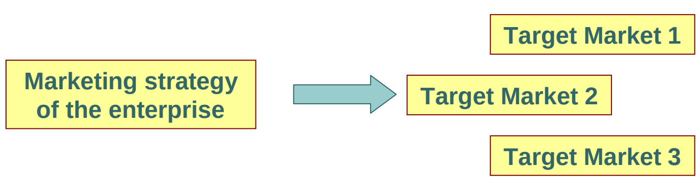
Approaches to market segmentation

- Market aggregation
  - Marketing management has only one market offering aimed at the total market



Approaches to market segmentation, cont'd

- Single segment approach
  - Marketing management has selected a specific target market and aims its market offering at it
  - No attention is paid to other segments in the market



Approaches to market segmentation

- Multi-segment approach
  - n-separate market offerings are made to n-different target markets.

Marketing strategy → Target Market 1

Marketing strategy → Target Market 2

Marketing strategy → Target Market 3

Basis for market segmentation

- Demographic criteria
- Geographic criteria
- Psychographic criteria
- Behavioural criteria

- See table 13.2

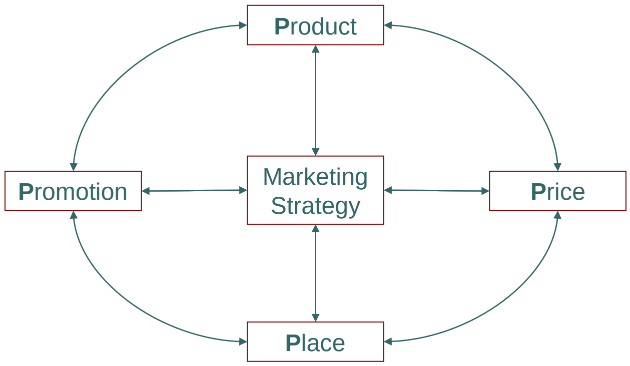
Chapter 14

The Marketing Instruments

Introduction: learning outcomes

- Explain the use of marketing strategy as an important part of the task of marketing management
- Understanding the 4 P’s

The marketing strategy: The 4 P's



Product decisions

- The **product offering** of a business may comprise a single **product item** or a number of product items & **product ranges**.
- E.g. The **product range** for VWSA consists of:
  - Passenger cars
  - Bakkies
  - SUV's
  - Heavy transport vehicles
- The product range consists of various **product lines**.
  - Citi Golf
  - Golf
  - Polo
  - Jetta
  - Passat
  - Caddy
  - Etc.

- The Golf GTi is a **product item**

What is a product?

- **Definition.**
  - A composition of tangible & intangible need satisfying utilities offered to consumers by a business, so that they can take note of them, procure them, and use them.

A consumer product

- A consumer product consists of
  - **A core product.** Could be described i.t.o. technical & physical qualities.
  - **A formal product.** In addition, may also include such specific features as style, quality, brand, & packaging.
  - **A need-satisfying product.** Includes further need-satisfying utilities, such as guarantees, installation, repair services & free delievry.
  - **A product image.** Gives the product symbolic value by means of marketing message, price, & choice of distribution outlet.
  - **The total product.** Consists of all of the above.

Types of consumer products

- **Convenience.** E.g. sweets, cigarettes, milk, bread, & newspapers.
- **Shopping.** Here, the consumer compares suitability, quality, price and style of these products before buying.
- **Specialty.** Products with unique characteristics for which consumers make a special purchasing effort. E.g. NAD, Ferrari Enzo, etc.

Brand decisions

- A brand is a mark that is unique to the product items or ranges produced and marketed by a particular business, which is chosen to distinguish them?
- **Benefits of brands**
  - They facilitate the identification of products when purchasing
  - They assure consumers of a quality standard they can count on
  - They offer a certain degree of protection to consumers, because branded products can be associated with a specific manufacturer
  - They facilitate decision-making, because consumers easily recognise the they buy (brand salience)
  - They serve a warning against products that do not meet requirements set by consumers.

Brand loyalty

- Occurs when consumers show loyalty to certain brands
- It is a result of good quality, proven usefulness, & repeated marketing communication
- **Three phases of brand loyalty:**
  - **Brand recognition.** Consumers recognise the brand know what it stands for.
  - **Brand preference.** Consumers prefer the brand over other competing brands.
  - **Brand insistence.** Consumers insist on the specific brand & refuse to accept a substitute

Brand types

- **Manufacturer.** Include originals such as Levi's, Green Cross, etc.
- **Dealer.** E.g. Ackerman's Baby labels.
- **Generic brands.** AKA no-name brands.
- **Family/individual.**
  - **Family** (branded house):
    - E.g. BMW – BMW 3 Series, BMW 5 Series, BMW 7 Series, BMW X3, etc.
  - **Individual** (house of brands):
    - RMBH – FNB, RMB, Outsurance, Wesbank,etc.
    - Bidvest (e.g. Waltons, Safcor Panalpina, Master Currency, Rennies Bank, Prestige, etc)

Packaging decisions

- **Packaging defined:**
  - a group of activities concerned with the design, production and filling of a container or wrapper with the product item in such a way that it can be effectively protected, stored, transported and identified, as well as successfully marketed
- Different kinds of packaging:
  - **Family packaging.** All the products in the range are more or less identically packed – the same packaging material is used, and the size of the packaging is more or less the same. E.g. KOO Baked Beans
  - **Specialty packaging.** This gives and image of exclusivity of the product. E.g. Chivas Regal, perfumes, jewelry, etc.
  - **Re-usable packaging.** Creates an impression that the consumer receives a 'free' container of s/he buys the products. Consumers tend to collect the containers, e.g. Bakers Tennis Biscuits in a metal container, etc.

Product differentiation

- Means that a business distinguishes its product, whether physically and/or psychologically, from what are essentially identical competing products, so that it is regarded as a different product by consumers in a specific target market.
- Kinds of differentiation.
  - **By means of packaging.** Plastic, foil or waxed paper, brands, label design, colours?
  - **By advertising appeal.** E.g. Hansa Ads.
  - **On the basis of price.** E.g. Premium Beer vs. Non-premium
  - **On the distribution outlet.** Rolex is available at only the premium jewelers.

Product obsolescence

- A product may be intentionally made obsolescent, e.g. Mitsubishi Pajero being replaced by Mitsubishi Outlander in a short time-span.

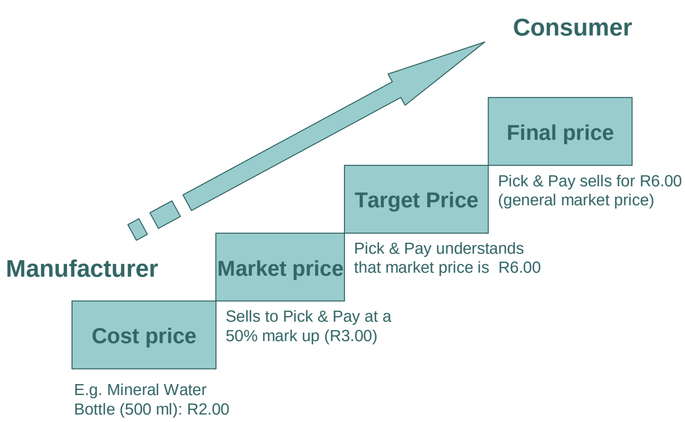
Multi-product decisions

- **Product range extension.** Ranges can be extended by making additions to existing ranges of products marketed by the business. E.g. FNB: Credit cards for different types of people/businesses.
- **Product diversification.** Exploring unknown products or markets. E.g. BMW X5, Volvo XC90 (SUV / 4 X 4 markets)
- **Product withdrawal**. When product items or ranges do not meet requirements or are no longer profitable. E.g. Lion Lager

Price decisions

- Definition: Price
  - The exchange value of a product or service, and is closely linked to concepts such as benefit and value

Price determination process



Adaptations to final price

- **Skimming prices.** If product is an innovation, & therefore unique, final price may be higher than normal.
- **Market penetration price.** The initial price of a new product is lower, & the marketer hopes to penetrate the market rapidly, discouraging competitors in the process.
- **Market price level.** This is a strategy followed if there is keen & numerous similar products that compete against each other. Catch 22: if s/he sets price below, consumers might think that there is something wrong with it; if the sets it higher, consumers would tend to avoid it.
- **Leader prices. Specials**. Sold at lower than current market price for a limited period only. Aim: To lure consumers to the store.
- **Odd prices.** Consumers are thought to accept odd prices, e.g. R1.99, R94.99, etc.
- **Bait prices.** Unethical therefore should be avoided by retailers. A bait product has a particularly lower price & is widely advertised. When arriving to the store, consumers are encouraged to buy a more expensive item. E.g. timeshare, etc.

Choice of distribution channel

manufacturer → Consumer
E.g. Dial Direct

manufacturer → retailer → Consumer
E.g. Pick & Pay

manufacturer → wholesaler → Consumer
E.g. Makro

manufacturer → wholesaler → Retailer → Consumer
E.g. Spaza

manufacturer → wholesaler → wholesaler → retailer → Consumer
E.g. foreign wholesaler selling to SA

Marketing communication

- Marketing communication is the process of informing, persuading & reminding the consumer. Its 4 elements are:
  - **Advertising.** The controlled & paid non-personal marketing communication related to a need-satisfying product & directed by a marketer at a specific target audience.
  - **Personal selling.** Verbal presentation of a product, service or idea to one or more potential purchasers in order to conclude a transaction.
  - **Sales promotion.** Marketing communication methods not normally classified as advertising, personal selling, or publicity, but that complement these in trying to influence consumer behaviour. E.g. diaries, events, etc.
  - **Publicity.** Non-personal stimulation of the demand for a product or service of a business by making its actual current news value available to the mass media to obtain a favourable and 'free' review of the business and its product in the media.

Chapter 15

The Integrated marketing Strategy

Introduction

- Marketing concept directs all marketing decisions about products, price, place (distribution) and promotion.
- The marketing concept comprises of:
  - Profitability
  - Consumer orientation
  - Social responsibility
  - Organisational integration

The principle of consumer orientation

- Marketing orientation places the consumer’s needs at the core of the marketing offering
- Though the consumer is ‘KING’, their needs cannot be completely satisfied
- It is argued that it is more harder & expensive to lose a client than to keep one.
- Marketing communication is hence essential to communicate to the consumer correct & adequate information about the business’s market offering

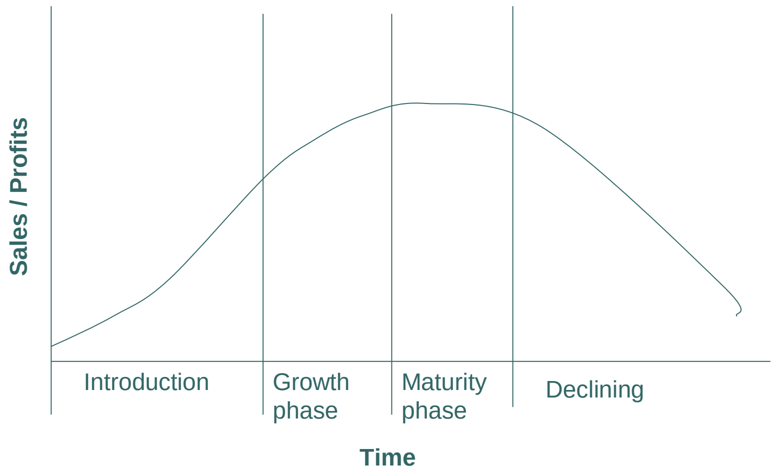
The principle of social responsibility

- Organisations operate within communities and 'ploughing back' is essential
- Education, housing, job creation & health are some examples
- Their objective is to create a stable economic, social & political environment in which future profits could be optimised
- Legislation also dictates how companies should operate other punitive measures could be applied
- A sponsorship or social responsibility must have some marketing benefits for the company
- Doing something 'contra bonos mores' could have detrimental results to the community. E.g. chemical producers need to ensure that their waste material does not contaminate rivers and streams, which could lead to health problems.

The principles of profitability and organisational integration

- This principle expresses close co-operation between all functions of business
- They all should be coordinated in a way that will eventually lead to the successful marketing of the products/services of the business.
- Businesses in the free-market system operate to maximise profit

Marketing strategy during product life-cycle



Integrated marketing strategy during introductory stage

- **Objective.** Create a demand!
- **Target market.** Consumers that are adventurous & readily able to try new things & run risks
- **Product decisions.** E.g. dimensions, colour, etc.
- **Place (distribution).** Exclusive / market coverage: only a few shops will be prepared to allocate shelf-space
- **Price.** High initial price is fixed since a new product has a high degree of prestige value
- **Communication.** Personal selling to dealers. Full-page colour advertisements appear in prestigious periodicals

Integrated marketing strategy during the growth phase

- **Objective.** Develop demand
- **Target market.** Consumers that are less receptive to new things & new ideas.
- **Product decisions.** Minor product modifications are made. The brand is emphasised.
- **Place.** Selective market coverage.
- **Price.** Price declines because of competition.
- **Communication.** Advertising through mass media (newspapers, radio, & tv)

Integrated marketing strategy during maturity phase

- **Objective.** Counteract competition & prolonging lifecycle of product
- **Target market.** New target markets are sought. Large market share is sought. Most consumers are aware of the product & its benefits.
- **Product.** Modifications or improvements have to introduced to differentiate it from numerous similar products in the marketplace
- **Place.** Intensive market coverage. All dealers with relevant facilities are allowed to stock and sell the products
- **Price.** Current market to be adhered to unless if differentiation successful
- **Communication.** Persuasive advertising through mass media.

Integrated marketing strategy during declining phase

- **Objective.** Maintain market share or withdraw.
- **Target market.** Older, more consecutive group of consumers who resist change & avoid innovation (set-in-their-minds)
- **Product.** No modification needed, but development of substitute new products or models
- **Place.** Limited market coverage, & only in areas where the product is in high demand
- **Price.** Prices are reduced and sales offered
- **Communication.** Personal selling & advertising only in areas where the product is still in high demand

Marketing warfare during the product lifecycle

- **Frontal attack.** A competitor is threatened on all fronts. Products are matched against products, prices against prices & advertisement against advertisement
- **Flanking attack.** Surprise attack on the opponent's weak points.
- **Encirclement.** Attacks launched on many different fronts. Similar products are launched in the same target markets using the same distribution channels and 'me-too' marketing messages
- **Guerilla attack.** Surprise attacks are launched at the opponent's weak points while a frontal attack is being planned.

Chapter 15

Public Relations

1

Definition: PR

- Public relations is a deliberate, planned & sustained process of communication between a business and its publics for the purpose of obtaining, maintaining or improving good strategic relations and mutual understanding between the organisation and its various publics – both internal & external

4

Reasons for the development of Public Relations

- Trade unionism around the world
- Consumerism. Need to establish links with consumer groups
- Competition. Benefits of positive corporate image essential
- Hostility by youth towards large businesses. E.g. *Laugh-it-off* satirical jokes
- Businesses operate within social structures
- Awareness of social responsibility of businesses
- Development of communication media (newspapers, tv, radio)
- Businesses' need for economic growth. Negative experiences like retrenchments mean businesses need to communicate with the public. Retrenchments could be regarded as being *contra bonos mores*.
- SA's continued reputation for bad service.

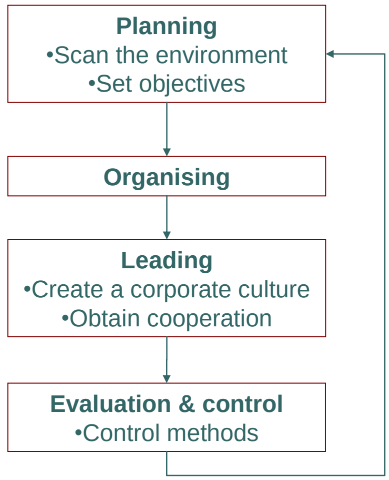
5

What PR is not!

- **Is not**
  - Part of marketing communication although both marketing & PR overlap in areas of advertising & publicity
  - A charitable organisation, even if it often contributes to an image of involvement & responsibility
  - Part of HR department. Although the HR, labour & PR departments are interested in the conditions in the labour market
  - Currying (necessarily) favour through entertainment & parties, although they are necessary to show goodwill towards certain groups
  - Intended to put up a false front behind which the defects of business could be hidden
  - Does not mean employing attractive young women to put guests in good mood, although attractive & agreeable people are always an asset when dealing with important people
  - There to think up foolish & expensive ways of wasting money
  - Out there exclusively to put out fires & save a business from different situations, although it may sometimes be called upon to do so

6

Steps in PR management



7

Organising PR

- **PR as part of top management**. Here PR is part of top management & the PR practitioner is on equal footing with top managers, such as marketing, production, HR, etc.
- **PR as a staff function.** In this case, the head of PR is usually responsible only to the general manager & has no line responsibility.
- **PR consultants from outside**. Consultants provide necessary services to smaller businesses that do not have the expertise or resources. Reasons why services of these experts are used include:
  - A business may lack the necessary knowledge and/or experience
  - The head office may be so far removed from communication & financial centres as to make liaison difficult
  - PR consultants usually have a wide range of useful contacts in the business sector & the mass media
  - They often offer services of experienced specialists who earn salaries that a small business could not afford
  - Critical matters that concern the general image of the business often require independent, objective judgment of an outsider
  - An emergency situation may require an external expert

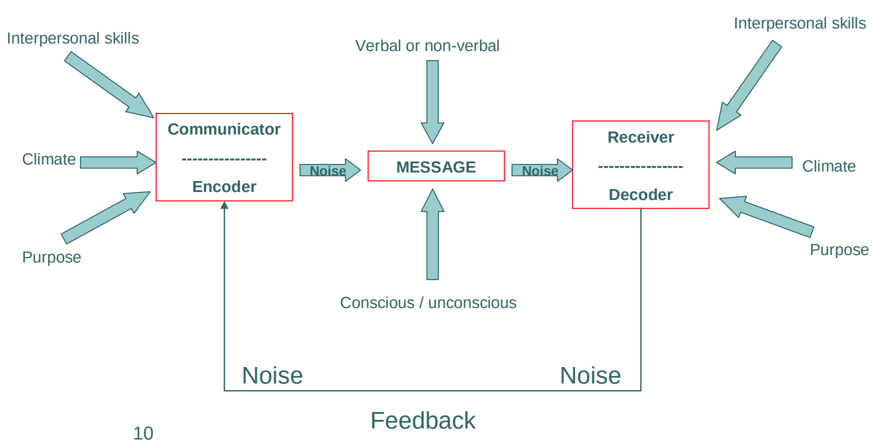
8

Examples of PR activities

- See figure 16.4
- Research
- Networking
- Exhibitions
- Conferences
- Special events

9

The communication model



10

Communicator

- Humans exchange ideas & opinions by conveying a message to someone who can understand it
- They communicate by the manner in which they speak, how they sound, their appearance, or actions & gestures that accompany their actions
- Conscious transmission: deliberate attempt to convey an idea
- Unconscious transmission: unintentional conveying of information
- The sender has to have credibility, i.e. the reader has to have confidence in the sender & respect for his competence with regard to the subject matter.

11

Receiver

- Communication occurs when there is a receiver for the message transmitted.
- Messages could be received through senses of hearing, sight, smell, & touch
- ‘Noise’, i.e. anything that interferes with the reception of the message, could get in the way of receiving the message
- The receiver may not always be a single person, e.g. a group of people the message is targeted at (target audience)
- Target audience could be employees, a specific group of consumers, shareholders, the government, or the public at large

12

The message

- The message is the idea or information being transmitted
- Two kinds of messages, i.e.
  - Verbal (spoken or written)
  - Non-verbal (e.g. symbols)
- The message must make sense to the receiver & must have reference to their situation & value system
- It must be simply composed & should carry the same meaning for both the communicator & receiver
- Must be sent via suitable channels, e.g. radio, tv, internet, newspapers
- Face-to-face communication is the most effective method, e.g. Eskom power failures
- The message should be formulated in such a way that it engages the receiver's attention, arouses their interest, & persuades them to respond (call to action)
- Persuasive message need specialist knowledge, e.g. communications agencies

13

The communications media

- The spoken word
  - The face-to-face communication
  - E.g. news conferences, panel discussions & interviews, often on radio & tv
- The printed media
  - Newspapers, magazines & company publications
  - Company publications, e.g. handbills, brochures, annual reports, news sheets, books, guides, road maps, recipe books, posters, desk diaries, personal newsletters, etc.
  - Magazines:
    - General magazines with articles on a variety of general interest & wide public readership, e.g. You, Drama, etc.
    - Aimed at a particular audience, e.g. Men's Health – Men, True Love – Women
    - Specialised publications for those interested in a particular sport type, or with specific interests (e.g. Getaway or longevity)
    - Professional journals read by academics, lawyers, doctors, farmers, engineers, etc. (e.g. Financial Mail, Engineering News, Enterprise)

14

The communications media, contd.

- Sight & sound
  - Radio & tv. TV could be used to
    - Present prestige advertisements, designed to build a business image & to make its brands known to the public
    - It can provide news reports, e.g. when there are notable achievements, etc.
    - A PR Officer may appear on news reviews or participate in discussion programmes in which newsworthy topics are discussed at length
  - Films & video. E.g. in cinemas or tv.
- Special events
  - Press conferences
  - Visits to the business
  - Receptions
  - Exhibitions
  - Crisis management
- The internet

15

Chapter 17

The Financial Function

1

Concepts in Financial Management

- **The balance sheet, asset & structure**
  - A balance sheet is a financial 'snapshot' that summarises the value (assets less liabilities) of a business at a specific point in time. All businesses have to prepare a balance sheet as part of their annual accounts, but a balance sheet can be prepared at any time.
  - A balance sheet is one of the three major financial statements used in the business world. The others are the Income Statement and the Cashflow Statement.
  - Where the Cashflow Statement shows the liquidity of your business (do you have enough cash to pay the bills and salaries), and the Income Statement shows you how much profit or loss you are making, the Balance Sheet shows:
  - How solvent the business is;
  - How the business is financed;
  - How much capital is employed in the business; and
  - How quickly assets can be turned into cash.

2

The balance sheet: Asset side

- The asset side reflects all the possessions of the business, together with their respective values as at the balance sheet date. Assets are normally divided into 2 broad categories, viz.
  - Fixed assets
    - Also called non-current assets
    - Land, buildings, machinery & other equipment
  - Current assets
    - E.g. cash in the bank, as well as other possessions that would be converted into cash within 1 year during the normal course of business, such as marketable securities, debtors & all inventories

3

Liabilities

- The liability (claims side) reflects the nature & extent of the interests in the assets, i.e. mutual coherence of the claims of the persons or institutions that provided funds (capital) for the 'purchase' of the assets
- It is usually divided into:
  - The term for which the funds have been made available
  - The source from which the funds have been obtained

4

Liability, contd.

- Contains the following details
  - Long-term funds
    - a.k.a. non-current liabilities & is made up of shareholders' interest & long-term debt
  - Short-term funds
    - i.e. current liabilities, & represents all debts or credit that is normally repayable within 1 year.
    - E.g. bank overdrafts, trade creditors
  - Shareholders' interests
    - Further divided into owners' equity (ordinary share capital, reserves, & undistributed (retained) profit)
    - Long-term debt (debentures – i.e. bonds that are not secured by the assets of a firm), secured loans, & long-term credit)
    - A debenture is a loan secured on specific assets owned by a company and is repaid if a company runs into difficulties. They usually have a fixed rate of interest and a fixed maturity date and are often issued by companies with sizeable fixed assets, such as hotel groups and breweries

5

Capital

- The accrued power of disposal over the goods used by the business to generate a monetary return or profit
- Or monetary value of the assets of the business at a specific time
- A business need capital for investment in
  - Fixed assets, i.e. need for fixed capital
  - Current assets, i.e. the need for working capital

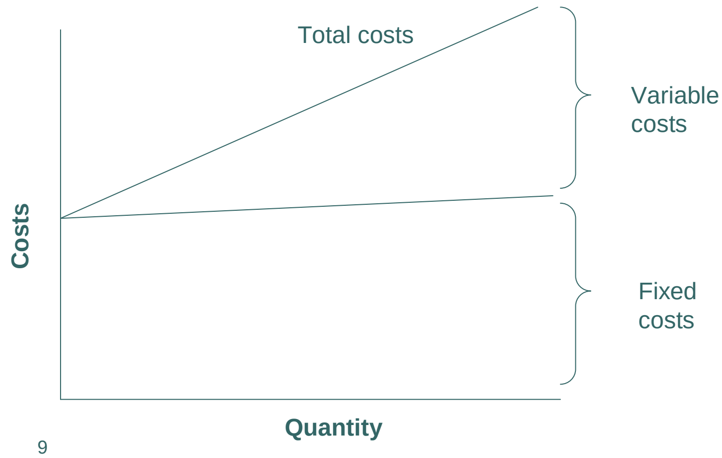
6

Costs

- Could be regarded as monetary value sacrificed in the production of goods and/or services produced for the purposes of resale
- In manufacturing they consist of
  - Materials used
  - Rent paid for the premises & building
  - Depreciation on equipment
  - Wages & salaries of all workers
  - Payments for electricity & communication services, etc.
- Total costs involved in the production of a specific number of products could be subdivided into
  - Fixed costs
    - i.e. that portion of total costs that remains unchanged – within the boundaries of a fixed production capacity – regardless of an increase or decrease in the quality of goods or services produced
  - Variable costs
    - That portion of total costs that changes according to a change in the volume produced.

8

Costs illustrated



9

Profit or loss

- Profits is regarded as the favourable difference between the income earned during a specific period and the cost incurred to earn that income
- A loss results when the costs exceed the income
- Profit or loss = income – costs

Or

- Profit = (selling price x sales quantity) - costs

10

Balance sheet as at 28 Feb 2006	R	R
Fixed assets		
Tangible assets	R40,000	
Equipment	R95,000	
Buildings		
Intangible assets		
Goodwill	R5,000	
		R140,000
Current assets		
Stock	R10,000	
Debtors	R20,000	
Cash in the bank	R5,000	
	R35,000	
Current liabilities		
Loans	R23,000	
Creditors	R7,000	
Tax	R2,000	
	R32,000	
Net current assets		R3,000
Total assets less current liabilities		R143,000
Creditors falling due after one year		R100,000
Net assets		R43,000
Capital and reserves		
Shareholders		R30,000
11 Reserves		R13,000
Net worth		R43,000

Chapter 18

Asset management: the investment decision

1

The management of cash and marketable securities

- Cash is the money (currency and coin) the business has on hand in petty cash drawers, in cash registers, and in current and savings accounts with financial institutions
- The costs of holding cash are:
  - Loss of interest. Cash in the form of notes and coins, and even money in a current account at a bank, earns interest
  - Loss of purchasing power. During a period of inflation there is an erosion in the value of money, which becomes even more serious if no interest is earned on that money

2

The costs of little or no cash:

- **Loss of goodwill.**
  - Failure to meet financial obligations on time due to cash shortages could seriously affect the relationship between the company and its employees, creditors, & suppliers
- **Loss of opportunities**
  - Cash shortages will make it impossible to react quickly to a lucrative business opportunity
- **Inability to claim discounts**
  - Discounts for prompt and early payment are very advantageous in percentage terms.
- **Cost of borrowing**
  - Shortages of cash may force a business to raise money at short notice at expensive rates

3

Marketable securities

- Marketable securities are investment instruments on which the business earns a fixed interest income. Also referred to as near-cash assets.
- Reasons why businesses should a certain amount of cash available:
  - The transaction motive.
    - Exists primarily because the business needs to have sufficient cash available to meet normal current expenditures such as payment of wages, salaries & creditors.
  - The precautionary motive
    - Entails keeping cash for contingencies, e.g. a competitor may be declared insolvent leaving an opportunity to acquire it
  - The speculative motive.
    - Implies that the business must be able to capitalise on good opportunities such as unexpected gains and bargain prices.

4

Cash budget

- Cash budget facility is a detailed plan of future cash flows for a specific period and is composed of the following elements:
  - Cash receipts
    - Originate from sales, collections from credit sales, bank loans, etc.
  - Cash disbursements
    - Categorised as cash paid for purchases of merchandise, raw materials, & operating expenses
  - Net changes in cash
    - Difference between cash receipts & cash disbursements

5

Cash cycle

- Indicates the time it takes to complete the following cycle (e.g. in manufacturing)
  - Investing cash in raw materials
  - Converting the raw materials to finished goods
  - Selling the finished products on credit
  - Ending the cycle by collecting cash
- Each cycle is a continuous process and the demand for cash should be greatly reduced if cycle is speeded up.

6

Management of debtors

- Debtors arise when a business sells on credit to its clients
- Normally given at 30 or 60 days, with extensions possible, e.g. 90 days or even 120 days!
- Credit extended to consumers is referred to **consumer credit**, whilst that extended to businesses is referred to as **trade credit**.
- The most important facets of debtor accounts are:
  - Credit policy
    - Contains directives according to which it is decided whether credit should be granted to clients, and if so, how much.
    - Evaluation of creditworthiness depends on
      - Character. The willingness of customer to pay
      - Capacity. The customer's ability to pay
      - Capital. The customer's financial resources
      - Conditions. Current economic or business conditions
  - Credit terms
    - Define the credit period & any discount for early payment
  - Collection policy
    - Concerns the guidelines for the collection of debtor accounts that have been by due dates

7

Inventory / stock management

- There exists a conflict between
  - **Profit objective**, i.e. to keep the lowest possible supply of stock, & to keep stock turnover as high as possible, in order to minimise the investment in stock, as well as attendant cash needs
  - **Operating objective**, i.e. to keep as much stock as possible to ensure that the business is never without, and to ensure that production interruptions and therefore loss of sales never occur

8

Costs of holding inventory stock

- Loss of interest
  - Interest that could have been earned on the money that is tied up in holding inventory
- Storage costs
  - Includes the rent of space occupied by the inventory stock & the cost of employing people to guard and manage stock
- Insurance costs
  - Risk associated to fire and theft and business interruption
  - Cover for these risks implies more premiums to be paid
- Obsolescence
  - E.g. Fashion stock is quick to be obsolete (3 – 6 months)

9

Costs of holding little or no inventory stocks

- Loss of customer goodwill
  - Failure to provide a supply of a customer due to insufficient stock may mean the loss of not only that particular order, but of other orders as well
- Production interruption dislocation
  - Running out of stock for some manufacturers can be costly. E.g. for a car manufacturer, this may mean a production stoppage
- Loss of flexibility
  - Additional stock holding creates a safety margin whereby mishaps of various descriptions can be accommodated without major and costly results
- Re-order costs
  - A company existing in little or no stock will be forced to place a large number of smaller orders with short intervals between each order.

10

Chapter 19

Financing decisions

1

Financial markets

- Growing businesses require funds for new investments or to expand their existing production capacity
- These businesses have a shortage of funds, & to grow they must have access to funds from financial institutions and individuals
  - **Financial markets** are the channels through which holders of surplus funds (the savers) make their funds available to those who require additional finance
  - **Financial institutions** act as intermediaries between savers and those with shortage of funds
  - **Financial intermediation** is the process through which financial institutions pool funds from savers and make funds available to those requiring finance

2

Primary & secondary markets

- Primary market issues are the new issues of financial claims, i.e. securities.
- Some types of financial claims are negotiable & can be traded on financial markets
- Trading in these securities after they have been issued takes place in the secondary market
- The JSE is an example of where savers virtually convert their savings into cash
- Debentures and company shares are examples of negotiable instruments
- Savings and call accounts are non-negotiable claims

3

Money and capital markets

- The **money market** is the market for financial instruments with a short-term maturity
- Funds are thus borrowed and lent in the money market for periods of 1 (i.e. overnight) or for months
- The **capital market** is the market for long-term investments that are raised and traded by investors.
- Much of the capital market trading happens at the JSE, however, they can also be done privately

4

Types of institutions: Deposit-taking

- Deposit taking institutions
  - South African Reserve Bank
    - Acts as banker for central government, advances loans to the state
    - Issues notes and also regulates private banks
  - Land and Agricultural Bank (Land Bank)
  - Corporation for Public Deposits (CPD)
    - Accepts surplus funds from departments, institutions & organizations in the public sector & is owned by the Reserve Bank
  - Private Sector Banks
  - Post Office Savings Bank

5

Types of institutions: Non-deposit taking

- Non-deposit taking institutions
  - Public sector institutions
    - Public Investment Commissioners (PIC). Operates as an investment intermediary for long-term public funds. It administers and invests the public sector's retirement & provident schemes & social security funds
  - Private sector institutions
    - Life assurers, pension & provident funds
    - Short-term insurers
    - Unit trust administrators
  - Other institutions
    - Industrial Development Corporation
    - Khula Enterprise Finance Limited.
    - Ntsika Enterprise Promotion
    - Development Bank of South Africa (DBSA)

PUBLIC INVESTMENT CORPORATION

Sanlam

AUTO & GENERAL
CAR, HOME & BUSINESS INSURANCE
We're looking after you.

6

Types of institutions: Non-deposit taking, contd.

- **OTHER INSTITUTIONS: KHULA ENTERPRISE FINANCE**
- Khula Enterprise Finance Limited is an agency of the Department of Trade and Industry **(dti)** established in 1996 to facilitate access to finance for SMMEs. Khula provides assistance through various delivery channels.These include commercial banks, retail financial intermediaries (RFIs) and micro credit outlets (MCOs). Through its Thuso Mentorship Programme, Khula also provides mentorship services to guide and counsel entrepreneurs in various aspects of managing their businesses.
- Khula is a wholesale finance institution, which means that entrepreneurs do not get assistance directly from Khula but through various institutions named above.
- Over the past five years, Khula has disbursed over R1 billion directly into the SMME sector. During the 2003/04 financial year alone, disbursements increased by 40% to R280 million. The number of beneficiaries also increased by 21% to 110 000 during the same period.

7

Source: www.khula.org.za

Short-term financing

- Trade credit
- Accruals
- Bank overdrafts
- Debtor Finance: Factoring & invoice discounting
  - Debtor finance is strictly not borrowing: it is not a loan, but involves the sale of debtors to a debtors company
    - Invoice discounting involves the sale of existing debtors and future credit sale to a debtor financing company. It then converts credit sales to cash sales and provides the business with a cash injection by releasing funds tied up in working capital. It is usually confidential, i.e. debtors are not advised of the arrangement!
    - Factoring is similar but goes 1 step further. Here, the financier also undertakes to administer & control the collection of debt. Here, debtors are aware of the arrangement. The factor is the financier to whom the debtors are sold.
    - The factoring/invoice discounting house will purchase outstanding book debts, against which they will advance up to 75% of the value. The balance will be paid once they have collected it from customers. See example on page 459!

8

Type of factoring

- Non-recourse
  - Here, the factor buys the debtors outright and bears the risk of bad debts. The factor accepts responsibility for credit control, debt collection & sales records. Customers pay the factor direct.
- Recourse
  - Here the factor provides the same services as in non-recourse factoring, but the seller guarantees that debts are recoverable. The factor recovers any debt from the seller.

9

Benefits of factoring

- The cost of debtor administration is transferred to the factor
- The turnover of current assets is increased and less capital is required to finance debtors
- Liquidity ratios improve
- More cash is available for other purposes

10

Short-term financing decisions

- **Matching Approach (hedging)**
  - Involves matching the period for which finance is obtained with the expected life of the asset. Financing arranged for periods longer than the life on asset is costly because it is not utilised for the entire period.
  - According to this method, fixed assets & permanent current assets are financed with long-term financing, & temporary current assets with short-term funds
- **Aggressive approach**
  - Instead of only using long-term funds, the manager uses more short-term financing than is needed. Permanent current assets are partially financed with short-term funds, instead of using only long-term funds as in the case of matching approach
- **Conservative approach**
  - Here, the manager uses more long-term funds than is needed. The temporary current asset requirement is financed with long-term funds. Since it involves the usage of mainly long-term funds, this approach is less risky and hence conservative.

11