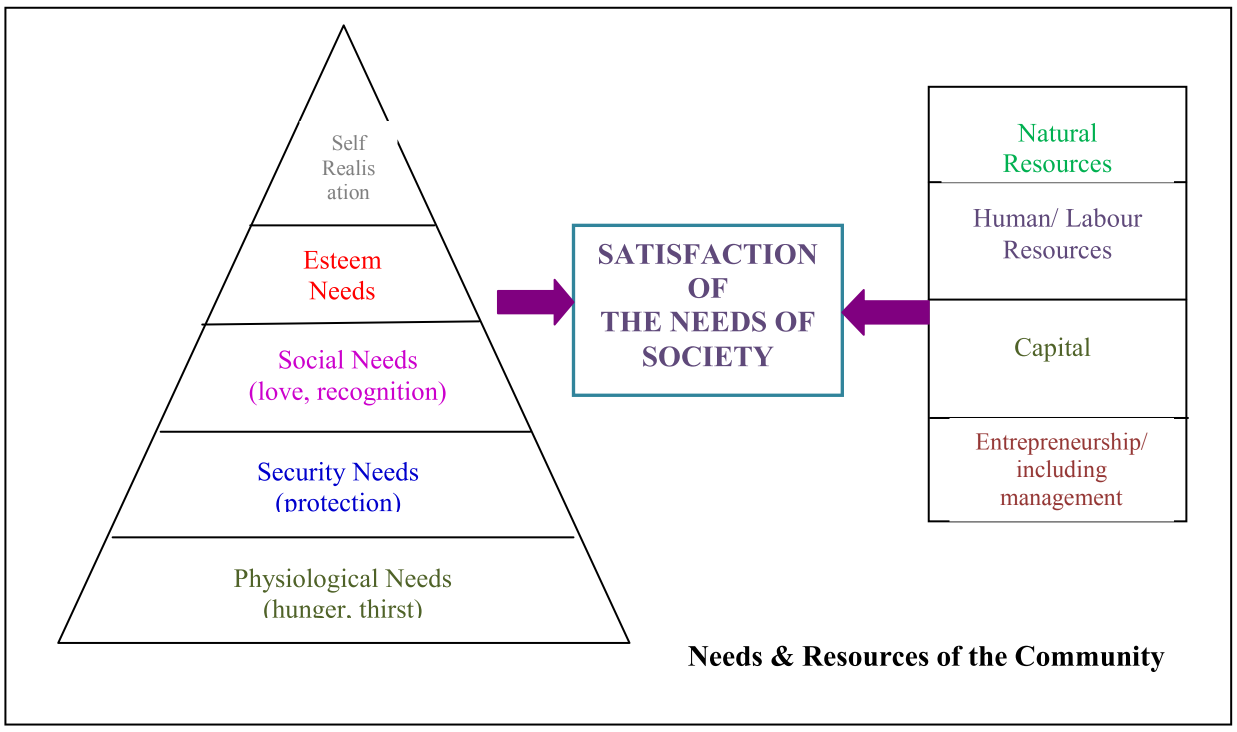
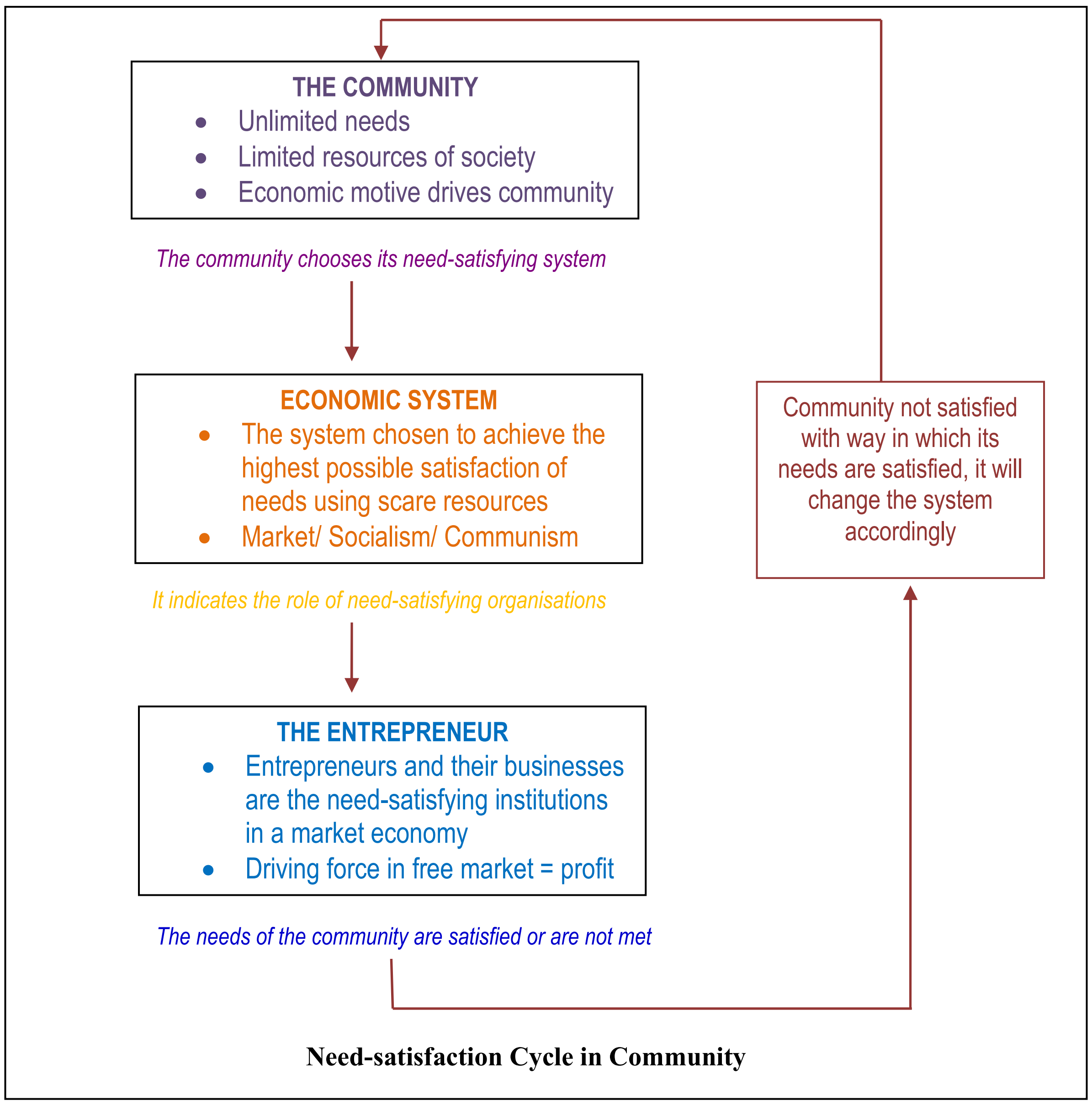
STUDY UNIT 1: Business ÷4 elements: Human Activities, Production, Exchange, And Profit





5 Factors of Production

1. Natural Resources
2. Capital (finance)
3. Labour (human resources)
4. Entrepreneurship
5. Knowledge

Economic Principle

Highest possible satisfaction of society's needs with goods & services with scare factors of production

3x Economic Systems

1. Capitalism (free-market)
2. Socialism (mixed system)
3. Communism (centrally controlled)

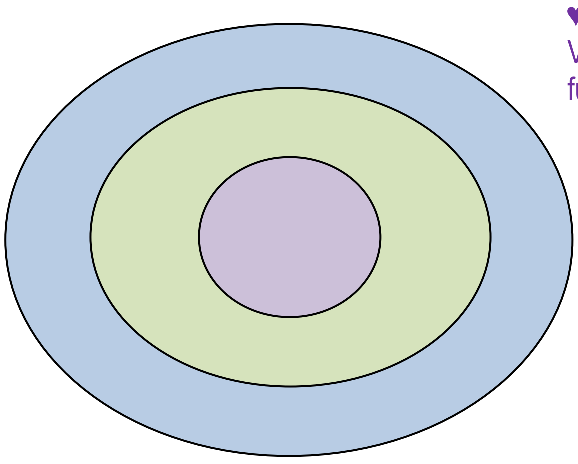
Entrepreneurship:

Use talents & abilities, take initiative in acquiring capital & natural resources, combine them & provide necessary management to convert original idea into a business.

Business Environment:

1) Changes Constantly
2) Must be in tune with changing environment
3) Opportunities & Threats exist
4) Establishment, growth, & continued existence directly influenced by business environment
5) Influences future of business

÷ 3: Micro / Market/ Macro



Micro

♥ of business

Variables = Mission statement & goals, business functions, management

Market

Link between business & business environment.

Variables = market, competition, suppliers of resources/services

Macro

Economic, Socio-cultural/ demographic, Technological, Physical (natural), Political/statutory, International

GENERAL MANAGEMENT:

(process whereby human, financial, physical and information resources are deployed in order to reach goals of organisation)

Systems Approach

INPUTS (resources)
- Human
- Financial
- Physical
- Information
- Entrepreneurship

→

TRANSFORMATION
- Physical transformation process
- Management process

→

OUTPUTS (performance)
- Achievement of goals
- Products
- Services
- Productivity
- Job creation
- Profit

Management Process/ Function

PLANNING
- What?

→ **ORGANISING**
- How?

→ **LEADING**
- When?

→ **CONTROLLING**
- Whether?

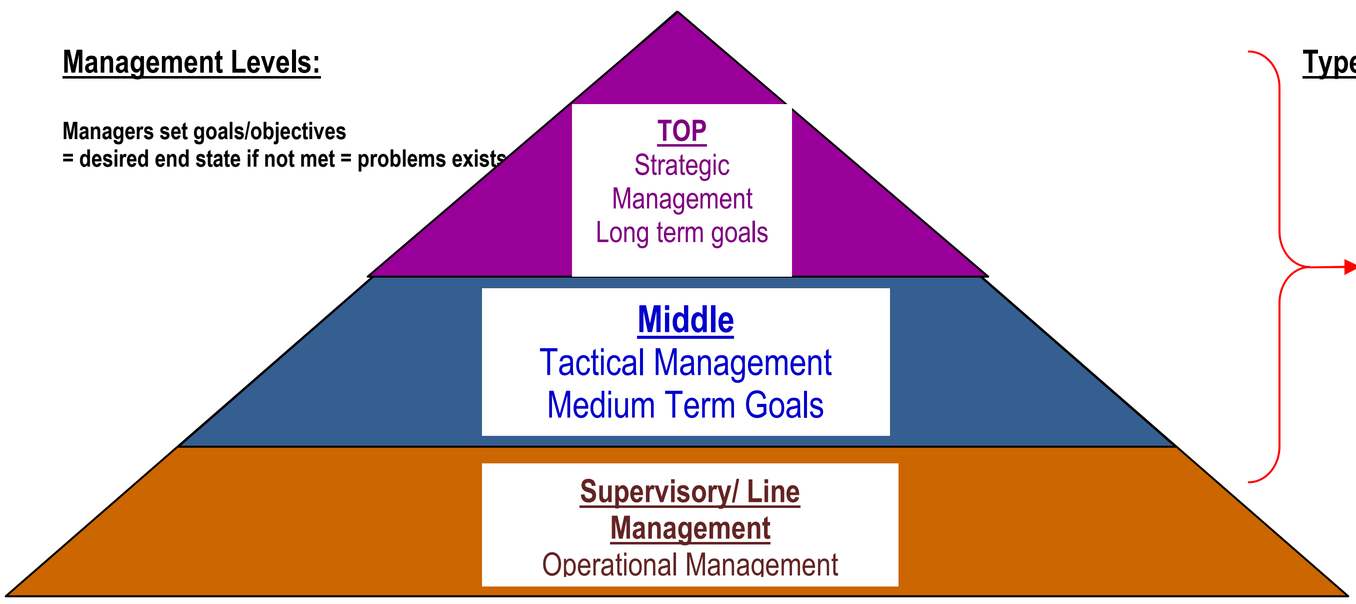
FEEDBACK!

Management Skills

Technical Skills	Necessary to accomplish specific task/ train & support subordinates
Interpersonal Skills	Ability to communicate/ understand/ motivate individuals/teams
Conceptual Skills	Ability to see & understand business as a whole entity/ think strategically & see big picture
Diagnostic Skills	Ability to diagnose symptoms & develop solution
Communication Skills	Convey and receive ideas from and to others
Decision Making Skills	Ability to recognise problems/ opportunities and formulate alternative solution
Time Management Skills	Ability to prioritise work, effectively/efficiently & delegate tasks.

Management Levels:

Managers set goals/objectives
= desired end state if not met = problems exists



Types of Decisions:

MANAGERIAL DECISION

Non-programmed Decision
Single-use plan

Programme project

Programmed Decision
Standing Plan

Rules & Regulations/ SOPs

Decision Making Conditions

Certainty:
(perfect knowledge available for each alternative & their consequences)

Risk:
(available alternatives, probability of occurrence & potential benefits/costs associated with them are known)

Uncertainty:
(risks are unknown, therefore need to gain insight and make logical/rational decision)

Rational Decision Making 6 Steps

1) Classify & define problem/opportunity
2) Set objectives and criteria
3) Generate creative alternatives
4) Analyse alternatives
5) Plan & implement decision
6) Follow-up and evaluate results

FINANCIAL MANAGEMENT:

(Value must be added by financial manager = custodian of shareholder's money therefore must know what affects share prices. i.e. how to increase share value)

ROLE OF FINANCIAL MANAGER:

1) **Business Start-up**
   - Determine long-term investment
   - Obtain long-term financing (equity or loans)
   - Debtor & creditors (short term)
     - What cash / inventory levels must be kept?
     - Sell/ purchase for credit or on cash?

2) **Analysis of business to determine value adding**
   Ratio analysis used to analyse where and how value is added throughout business v.s. competitors

   - Ratio Analysis
     - Assist in comparing business's performance & status with competitor or itself over period
     - Shareholder's, creditors and managers use information to determine how efficient and profitable business is
     - Income Statement and Balance Sheet used to input ratios
       - Profitability Ratios
       - Activity Ratios
       - Capital Structure/ Liquidity Ratios

   - Economic Value Adding (EVA)
     Rate of return on total capital determines value added by cash-generating projects & contributes to overall business performance
     Points to remember for EVA
     a) Calculated weighted average costs of capital
     b) Calculate net operating profit after tax (NOPAT)
     c) NOPAT take into account GAAP distortions
     d) Calculate the value of investment
     e) Calculate capital cost [a x d]
     f) Deduct [c –e)

     GAAP distortions consist of add back:
     - R&D
     - Training
     - Marketing

     Expenses that have long term benefits for business

3) **Financial planning (short/long term)**
   - Capital budgeting (means to identify best investment option)
     - Net Present Value (NPV)
     - NPV = estimated market value of business – cost of investment
     - Payback rule: how long will it take to recover investment money
     - Profitability index (PI) = PV ÷ original investment

   - Capital structure (viable combination of debt and equity)
     Financial leverage is obtained when debt is used – value is added to business and costs are reduced. Value is added via tax deductibility of interest paid, which lowers interest payment. BUT Higher debt = higher risk hence bank charges higher interest rate hence use Interest Cover Ratio to determine how effective the financial leverage has been.
     - Type of risks
       Business risk – the risk of the return on its assts being insufficient if no debt is used
       Financial risk – the onus falls on shareholder to bear a higher risk when the business decides to use debt.

   - Working capital management (management of current assets & liabilities)
     Must ensure right capital invested in short-term financing
     Working capital NB to ensure that cash is available to purchase stock, pay creditors, provide credit to debtors and pay for day-to-day expenses
     Net working capital = current assets – current liabilities
     Balance between CA and CL must be such that the amount of profitability and risk adds positive value to the business.
     Cash conversion cycle NB to ensure business has enough cash to cover its cost of x period.
     Cash conversion cycle can be shortened by:
     - Produce and sell products fasters
     - Shorten receivables period (i.e. collect $ from debtors faster)
     - Stretch payables deferral period (take longer to pay accounts)

4) **Budgets**
   Plan for future activities expressed in monetary terms

   Assist with planning & control processes of business = financial tool (indicates expected future & used as measuring tool)
   Budget control:
   Step 1: Setting standards (objectives set out in monetary terms)
   Step 2: Comparing actual performance with the standards
   Step 3: Evaluating and analysing actual performance
   Step 4: Taking corrective and preventative action