KEY CONSIDERATIONS

CHAPTER 9

Multiple choice

1.	D	**6.**	C	**11.**	C	**16.**	C
2.	A	**7.**	B	**12.**	C	**17.**	A
3.	D	**8.**	C	**13.**	C	**18.**	C
4.	D	**9.**	D	**14.**	A	**19.**	D
5.	B	**10.**	B	**15.**	B	**20.**	C

Matching terms

A licence to trade under an existing company name in return for an initial fee and ongoing commissions	**Franchise**
Funding from those who either own or have a shareholding in the business	**Equity finance**
The borrowing of money from a financial institution at an agreed interest rate	**Debt finance**
The ratio of a business's debt compared to its assets	**Gearing ratio**
An internationally recognised right to own intellectual property	**Patent**
The provision of a business activity by another, outside business	**Outsourcing**
The range of labour costs a business must pay in additional to wages	**On-costs**
The compulsory savings by employers for their employees, as governed by law	**Superannuation**
A distribution network where the business directly supplies the product or service to the customer	**Direct discrimination**
A distribution network where products are sold to other businesses, which then sell those products to consumers at an increased price	**Indirect discrimination**

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Short answer questions

Question 1

(a)
- A new business does not have a credit history, making it difficult to raise funds from banks and other financial institutions.
- A new business does not have an existing customer base. It takes time to foster relationships with customers and establish a good reputation.
- It often takes a long time before a business generates enough sales to make a profit. During this time, owners must use their own money to fund the business.

(b)
- Franchises often have high-levels of customer recognition, making it easier to foster customer relationships and generate immediate sales.
- Franchisors generally provide ongoing management assistance to franchisees. This helps franchisees to avoid mistakes that could threaten their business.
- Franchisees may also receive benefits such as bulk buying of supplies or access to the franchisor's advertising and marketing strategies.

(c) David could use either equity or debt funding to buy this business. Equity funding is money that the owner contributes to a business. That is, David could use his own money to purchase the local donut shop. Debt finance refers to funds borrowed from parties outside the business, such as banks or finance companies. Using debt funding would allow David to avoid committing his own money to the business. However, debt funding must be repaid with interest, adding an additional cost to David's business.

Question 2

(a) Leave loading: Additional payments on top of ordinary pay that businesses pay to their employees while they are taking annual leave. The ordinary rate for holiday leave loading is 17.5 per cent.

Superannuation: Money that a business must contribute to a retirement fund on behalf of all employees earning more than $450 per month.

(b) There are a variety of different methods businesses can use to hire new employees. Two of these are internal hiring – where a business hires new employees itself – and external hiring – where a business uses contract employees hired from a labour hire company. Internal hiring is a costly and time-consuming process, requiring a business to advertise available positions, review applications and hold interviews. In addition, if things do not work out between a business and an internally-hired employee, the businesses may have difficulty dismissing the employee. By contrast, external hiring is a cheap and convenient process as the labour hire business looks after much of the administrative duties. In addition, a business does not generally have ongoing commitments to contract employees. However, a business has less control over the quality of employees hired on contract, and it may be difficult to attract talented employees to work on this basis.

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(c) The process of hiring staff varies greatly according to the size and structure of a business. Large businesses are usually able to contribute substantial resources to finding and hiring the best candidate to fill an available position. They are able to advertise widely for positions and are able to take more time in the hiring process. If they do not have a specialised human resource management department, they may be able to use a job agency to identify and interview suitable candidates. By contrast, a small business may lack the financial resources or management expertise necessary to undertake a thorough job search. A small business is more likely to hire employees on the basis of personal contact or recommendations from individuals close to the business. A small business may, however, use a job agency to source temporary or casual employees. This is a cost-effective way of hiring additional staff for a small business that lacks the financial resources to commit to hiring further full-time staff. to work on this basis.

Question 3

(a)
- Distance to suppliers: Locating his business close to suppliers will allow Costa to minimise his transport costs. This will allow Costa to offer low prices to customers, giving him a competitive advantage.
- Location of customers: Locating his business close to customers will increase the probability that customers will visit Costa's store.
- Location of competitors: Locating his business close to other motorbike dealerships will make it easier for customers to compare Costa's motorbikes with those of his competitors. Once again, this will increase the probability that customers will visit Costa's store. However, if Costa's motorbikes are expensive or of low quality this could be a drawback.
- Visibility: Locating his store on a main road will increase the likelihood that customers will notice his store and also make it easier for customers to find.

(b) Equity finance: Equity finance does not need to be repaid, making it a low-risk funding option for a small business with uncertain cash-flows. In addition, if the business is successful, the equity holders get to keep all of the profits. However, using equity finance requires owners to put their own money on the line. If the business goes bankrupt, the owners will lose all their investment. In addition, the quantity of equity financing that a business can raise is limited by the wealth of its owners. In order to raise further equity finance, a business may have to bring in new owners, who may demand a say in how the business is run.

Debt finance: Debt finance is a cheap and easy way of raising funds for a business. Because the value that can be raised is limited solely by the business's ability to repay, a growing, profitable, business may be able to borrow large sums of money. However because debt finance has to be repaid with interest, it is generally considered to be more risky than equity finance.

Question 4

(a) Gross profit = Revenue - Cost of Goods Sold

= $220,000 - $74,000

= $146,000

(b) i) Revenue: Income flows into the business, primarily resulting from the sale of goods and services.

ii) Expenses: Costs incurred in owning and running a business such as rent, wages and promotional costs.

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(c) Net profit is equal to total revenue less total expenses. Many businesses record revenue and expenses when a transaction takes place rather than when cash changes hands. For example, if a business sells a hat to a customer on credit, it will record the value of the sale as revenue in its revenue statement. However, until the customer actually pays for the hat, the business will not receive any cash. Similarly, a business may incur an expense, such as buying hats from hat suppliers, which it does not pay immediately. This transaction will appear as an expense on the revenue statement, but will not result in a cash outflow until the business actually pays the bill.

(d) i) Wages are the cost of employing labour. Wages are equal to almost one-third of Harry's Hats total expenses. They could be reduced either by employing fewer staff, opening the store for shorter periods of time or by lowering wage rates.

ii) Bad Debts are an expense that Harry's Hats incurs because it has sold goods on credit to customers who do not eventually pay for these goods. Harry's Hats could reduce bad debts by insisting that customers pay cash for buying goods or services. Alternatively, Harry's Hats could improve its credit rating practices, ensuring that it only offers credit only to customers who are able to repay.

(e) Electricity expenses are an unavoidable cost of doing business. Nevertheless, high electricity expenditure may be a sign that a business is operating inefficiently. For example, employees may not be switching off electrical equipment in the evenings. This type of action imposes unnecessary costs on a business, reducing its profitability.

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