

Hotspur & Wren Ltd
Business Studies Case study Questions 2003

Chirag Sequeira 11M

SECTION 1 – BUSINESS ACTIVITY AND THE CHANGING ENVIRONMENT

1.1 OBJECTIVES

- (a) All business have objectives or targets to meet which are set out by the people who lead or control the business. Two possible business objectives of Hotspur & Wren could be survival, profit maximisation and expansion. Survival is required when trading becomes difficult, periods of recession and threats of takeover. Profit maximisation is producing a level of output which generates the most profit for a business.
- (b) (i) To communicate the objective with Shareholder's, the business could produce circulars which would be mailed to the customers. A forum might also be held to receive feedback about the proposed changes. Shareholders will be interested in the changes as they receive a dividend.
- (ii) To communicate with their customers however, the business might need to adopt other methods such as various media advertising methods, advertising agencies etc.

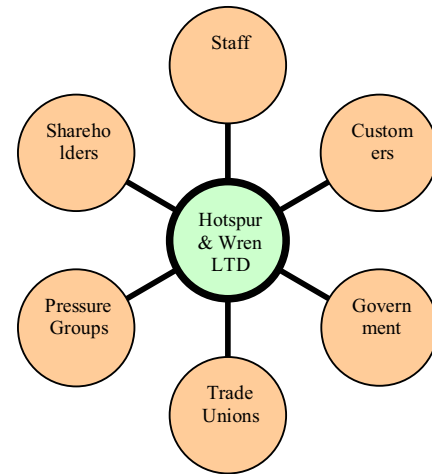
1.2 TYPES OF ORGANISATION

- (a) (i) Hotspur and Sons were a partnership.
(ii) Wren & Co is a private limited company.
(iii) Hotspur & Wren Ltd is also a private limited company.
- (b) Mergers and takeovers take place when firms join together and operate as one organisation. "Hotspur & Sons" and "Wren & Co" merged in 1967 and there are many reasons why businesses merge. Firstly, mergers are a quick and easy way to expand the business compared to opening and building new sites. Secondly, buying a business is usually cheaper than growing internally. Thirdly, firms can also lower their costs by joining with another firm and gaining economies of scale. Also, growth of the business might be one of its main objectives and the size of the business can be increased with a merger. Lastly, mergers can also take place for defensive reasons and to consolidate its position in the market.
- (c) (i) To become a PLC, Hotspur & Wren Ltd would have to produce two documents. The Memorandum of Association, which gives details about the name of the company, the address, the liability of members, the amount of share capital and a description of the business activities. The Articles of Association will also have to be produced which gives details about the voting rights of the shareholder, how profits will be distributed, the duties of the directors, and information about the AGM. These documents are sent to the Registrar of Companies and if successful, the company will be awarded the Certificate of Incorporation and can begin trading. PLC's have to raise capital from shareholders to be issued a Trading Certificate from the Registrar before starting trading.
- (ii) Below is a table showing the advantages and disadvantages of becoming a PLC for Hotspur & Wren Ltd:

| Advantages | Disadvantages |
|--|--|
| <ul style="list-style-type: none">• All members have limited liability.• Firm continues to trade even if one owner dies.• More power is enjoyed due to larger size.• Huge amounts of money can be raised from the sale of shares to the public.• Production costs may be lowered as firms may gain economies of scale.• Because of their size, PLCs can dominate the market. | <ul style="list-style-type: none">• Setting up costs can be very expensive; millions of pounds in some cases.• Since any one can purchase shares, outside interest can take control of the business.• All company accounts can be inspected by the public and competitors can use this information to their advantage.• Because of their size, they cannot deal with customers on a personal level.• Their operation is controlled by Company Acts, aimed to protect shareholders. |

(iii) Stakeholders are groups that have an interest in what happens as a result of the firm's activities. On the right are some of the stakeholders in Hotspur & Wren LTD.

(iv) The staff at Hotspur & Wren Ltd might influence the decisions made by the business as they want to see their working conditions improved. They might also be worried that any difficulties in their company could put their jobs at risk.



1.3 FACTORS OF PRODUCTION

- (a) Factors of production are resources used by businesses to produce goods and services. The four main factors of production are Capital, Enterprise, Land and Labour (CELL). Hotspur & Wren Ltd's capital are the tools, machinery and equipment such as the new ICT facilities, sewing machines and also their new store. Its labour would be the workforce of the business such as manual workers, skilled workers and management. The land would be any raw material such as wool, cotton, silk etc.
- (b) The merger might affect the fixed cost of Hotspur & Wren as its business would have expanded considerably. Costs, such as rents, insurance, heating bills etc will increase as production has been raised. The above fixed costs do not change as a result in change of output unlike variable costs.
- (c) Capital intensive techniques involve employing more machinery relative to labour. For example, Hotspur & Wren Ltd might produce curtains or carpets using machines. Labour intensive techniques involve using a larger proportion of labour than capital for example, hand-made carpets or personalised sofa designs.

1.4 INDUSTRIAL SECTORS

- (a) Hotspur & Wren Ltd is in the secondary sector of industry as it transforms primary products into manufactured goods.

1.5 LOCATION

- (a) There are various factors involved in the choice of location of a business. The decision of where to locate is crucial to many businesses as it can affect sales, costs, profitability and perhaps even survival. The main factors involved in the choice of location are as follows. The availability of raw materials (esp for primary industries) is an important factor as transport costs of materials can be expensive. Competition in the local area, legislation regarding marketing/ trading, availability of workforce, the local environment (constraints/ opportunities) are also factors. The Government and EU influence is also important.
- (b) Agreement with above

1.6 GOVERNMENT AND E.U. INFLUENCES

- (a) Countries to export to
- (b) European legislation
- (c) Value of Sterling

1.7 TECHNOLOGY AND ENVIRONMENT

- (a) Unemployment is concerned with people being out of work. Unemployment has a number of effects on businesses and its aims of expansion.

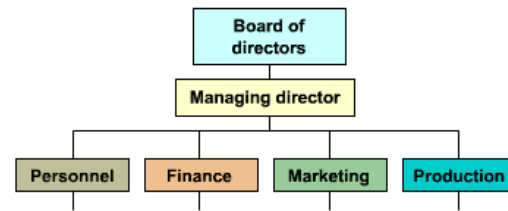
(b) There are several advantages of selling through the internet.

1.8 JUDGING SUCCESS

(a) To measure success of a business

SECTION 2 – HUMAN RESOURCES

2.1 INTERNAL ORGANISATION



1. William Hotspur is the group managing director. A managing director is involved and has responsibilities in the day-to-day running of the business. The director is often elected by the shareholders; however, it is not necessary for a managing director to own shares.
2. A marketing department, personnel, and finance department is present at Hotspur & Wren. The function of the marketing department is to market Hotspur & Wren Ltd's business and its products. They will have to carry out market research, product planning, packaging, pricing, sales promotion, advertising and distribution of the products. The finance department would be in charge of wages, salaries, cash flow forecasts, forecasting invoices and accounts. The personnel department are involved in recruitment, training, terms and conditions of service, contracts, disciplinary and grievance procedures, dismissal.
3. The merger between Hotspur & Sons and Wren and Co in 1967 would have affected the Marketing and Human Resources Departments.
4. The chain of command is the way authority and power is passed down in a business. The span of control however is the number of subordinates working under a superior. When two firms merge, the business will increase in size and therefore a longer chain of command with more levels of hierarchy may be present. The leadership styles of the owners might be different and so if the owner wanted to retain control of the business, the span of control would be narrowed. The business objectives might also provide for expansion, in which case, the chain and span of control would be different.

Delegation: authority passed down from superior to subordinate.

Hierarchy: the order or levels of management of a business, from the lowest to the highest.

2.2 COMMUNICATION

5. There are two main methods of communication, written and oral. The choice will depend on whether data has to be recorded, whether speed is important, and whom the letter is to be addressed to. The following are the methods:
 - Memo – internal Employees
 - Letter – internal / external Customers / Suppliers
 - Report – internal / external Customers / Suppliers
 - Oral – internal / external (small businesses) Employees
6. The above information can be communicated by paper, electronic methods, people and organisations. The letter is a reliable method as for information such as changes in ownership, a record is required.
7. Good communication is vital for the efficient running of a business. Effective communication will only happen if information is sent, received, and then understood. Hotspur & Wren Ltd will need to communicate with customers, employees, and suppliers to inform them about the change in ownership. If messages are not communicated effectively, incorrect data will be passed around and the possibility of misunderstandings is present.
8. Hotspur & Wren Ltd can use ICT to increase the effectiveness of their communication. ICT has revolutionised communication. By using facilities such as electronic mail and videoconferencing. Data can be instantaneously send data to multiple users and have real time conferences saving travel costs.

2.3 RECRUITMENT AND SELECTION

9. Hotspur & Wren Ltd could use two main methods of recruitments, internal and external recruitment. Internal recruitment takes place when an existing employee is appointed to a post. Hotspur & Wren Ltd could also employ staff for the new store externally. This involves an employee being hired from outside the organisation. This can be done through jobcentres (government usually manual labour), private employment agencies (charge for service, usually specialise), advertisements (newspapers) or simply word of mouth.

10. The following play a crucial role in Hotspur & Wren Ltd's recruitment process:

Job Description: document that describes the duties of a worker and his or her status in the organisation.

Job Specifications (or person specification): a profile of the type of person needed to do a job. (eg attainments, interests).

Advertising:

Interviewing:

11. If Hotspur & Wren Ltd were to advertise for new staff for the new shop there are several possible locations. It would be suitable for Hotspur & Wren Ltd to firstly advertise in the out of town shop to be closed (internal recruitment) using notice boards or a magazine. They might also try advertising through external sources such as the classifieds in newspapers. They might approach a job centre or an employment agency as they can target only blue collar workers for example.

12. When selecting workers for Hotspur & Wren Ltd's new outlet, they need to have a selection process. Applicants have to firstly produce a letter of application (with CV and covering letter). The applicants can then be short listed and invited for an interview.

13. Legislation when recruiting staff

14. Equal Opportunity legislation

2.4 TRAINING

15. Induction training programs are usually provided to new recruits introducing the employee to the business. Induction training usually focuses on the way the business works and not the job the employee will be doing. Induction training also prevents new employees from quitting during early weeks of employment.

16. There are two main training methods, on-the-job training and off-the-job training.

17. ICT equipment

18. Well trained staff

19. Good training scheme

2.5 MOTIVATION AND REWARDS

20. Abraham Maslow (1954) – Hierarchy of needs

Maslow suggested that 'classes' of need could be placed into a hierarchy.

In a hierarchy the things at the top are more important than those at the bottom. Maslow said the lower levels have to be satisfied first. Only when these needs have been satisfied will the individual strive to satisfy the higher needs. For example, hungry, cold people will seek food and shelter first. Once they are well fed and comfortable, they will turn their attention to higher needs, for example the pleasure of being with colleagues.

How can a business provide for these needs?

Basic needs: for food, drink and shelter

A fair wage, a meal and rest facilities.

Safety needs: protection against danger, threat, deprivation

Job security, safe working conditions, pension schemes.

Social needs: the need for belonging, acceptance, friendship

Met by introducing team work and perhaps providing social facilities like a club or sports pitch.

Self-esteem needs: reputation, status

This is about how others see us at work and can be provided for by rewarding staff with status symbols like cars, offices and new job titles. Allowing staff to gain qualifications at work can boost self-esteem too.

Self-actualisation: the need for realising one's own potential for continual self-development
Achieving your full potential. A business must ensure that promotion is possible and that there are opportunities to use initiative.

Fredrick Herzberg (1966) – Two factor theory

21. Wages / salaries -

Commission – this is a payment system where employees are paid a percentage of the value of each good or service that is sold.

Bonuses – usually an extra payment made in recognition of the contribution a worker has made to the company.

Profit sharing – Employees are paid a proportion of the annual profits of the company.

Share ownership

22. Time rate – a payment system that rewards workers for the amount of time they spend at work.

Piece rate – a payment system where employees are paid an agreed rate for every item produced.

Commission

Salary

23. Job Enrichment / Job Enlargement

2.6 NEGOTIATION AND CONSULTATION

24. A trade union is an organisation of workers that join together to further their own interests.

25. The trade union would be involved in ensuring satisfactory rates of pay, adequate work facilities and acceptable working conditions during the merger and in the new company. They would also be involved in the negotiation with the management about grievances, conditions, bonuses etc.

26. If workers had to protest against a process such as the merger there is several actions that can be taken. Firstly, the union could 'Work to rule' and not carry out tasks unspecified in their contracts or carry out the process slowly (still abiding by contract). The employees could have carried out a strike which is stoppage of work. Strikes can be official or unofficial. They might also hold sit-ins which are mass occupations of the premises by workers.

27. Consultation

28. Collective bargaining is a method of determining conditions of work and terms of employment through negotiations between employers and employee representatives. Industrial action is action that can be taken by the employer or the employee against each other to reconcile differences.

29. Employee's rights

30. Employers' associations

SECTION 3 – ACCOUNTING AND FINANCE

Balance sheet for Hotspur & Wren Ltd as at 31/03/2003

| Current Assets | | Current Liabilities | |
|----------------------|---------------|---------------------------------|---------------|
| Debtors | 40000 | Bank Overdraft | 42692 |
| Stock March 31st | 104000 | Creditors | 87500 |
| Total Current Assets | 144000 | Total Current Liabilities | 130192 |
| Fixed Assets | | Fixed Liabilities | |
| Delivery Vehicles | 100000 | Loan from RTL bank due 2009 | 216000 |
| Goodwill | 135000 | Total Fixed Liabilities | 216000 |
| Office Equipment | 96600 | Total Liabilities | 346192 |
| Computer Equipment | 120000 | Proprietorship | |
| Total Fixed Assets | 451600 | Capital - Hotspur & Wren | 364408 |
| | | Net Profits | 49000 |
| | | less Drawings of Hotspur & Wren | 164000 |
| | | Total Proprietorship | 249408 |
| Total Assets | 595600 | Total Equities | 595600 |

Question 1

-
- An asset is a resource owned by the business used in production. It must earn revenue for the business.
- Current assets are short term assets which are expected to be converted into cash within one year. An example of a current asset would be stock or debtors. Fixed assets are long term resources of a business such as office equipment or machinery.
- Depreciation is the falling in value of an asset. Depreciation can occur due to wear and tear or technical and commercial outdateding.
- Drawings are money withdrawn by a sole trader from the business for personal use. It is not classified as an expense as expenses are costs incurred in earning revenue. Therefore drawings are a negative proprietorship.
- A balance sheet is a summary at a point in time of business assets, liabilities and capital. Balance sheets have to be prepared by limited companies for its shareholders as it is a legal requirement. Balance sheets also provide useful information to investors and potential investors to help them value the business.
- The current ratio shows the relationship between the current assets and the current liabilities:

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{144000}{130192} = 1.1069$$

- The acid test ratio is similar to the current ratio, but it excludes stock from current assets in the calculation. Stock is the least liquid of the current assets, since they have not been sold:

$$\text{Acid Test Ratio} = \frac{\text{Current Assets} - \text{Stock}}{\text{Current Liabilities}} = \frac{144000 - 104000}{130192} = 0.3079$$

- The return on capital employed (ROCE) expresses the profit of the business as a percentage of the capital invested in it:

$$\text{Return on Capital Employed} = \frac{\text{Net Profit after Tax} + \text{Tax on Profits}}{\text{Total Capital Employed}} \times 100 = \frac{4000}{58000} \times 100 = 8.2\%$$

Question 2

10. (i) Cash received and profits earned might be different as some transactions are done on credit and therefore does not lead to cash flow into the bank at that time. The owner might also take drawings from the business, which is not an expense. A loan could also be taken by the business which brings in cash to the business but not necessarily revenue.

| | Jan | Feb | Mar | Apr | May | Jun | Jul | |
|----------------------|---------|---------|---------|---------|---------|---------|---------|----------|
| Receipts | 2000000 | 2500000 | 3500000 | 3500000 | 3000000 | 2500000 | 2400000 | 19400000 |
| Payments | 2100000 | 2800000 | 3450000 | 3600000 | 2800000 | 2600000 | 2200000 | 19550000 |
| Net Cash Flow | -100000 | -300000 | 50000 | -100000 | 200000 | -100000 | 200000 | -150000 |

(ii) The above forecast shows problems for Hotspur and Wren Ltd. From the Receipts and payments for the period of months supplied, the total net cash flow runs into negative 150000. This represents a liquidity problem as it prevents the business from running on a day-to-day basis. However, by the end of July, the cash flow was improving from what it was in April (-450000). If the business continues to operate in this manner they may be able to go positive by the end of the year.

Question 3

1. An expense from General & Administration could be rent of premises, insurance or cost of electricity.
2. A sales & distribution cost might be transportation costs or advertising.
3. A financial cost might be discounts allowed or bad debts.
4. The Gross Profit Margin expresses operating profit before tax and interest:

$$GPM \text{ (200 / 201)} = \frac{\text{Gross Profit}}{\text{Turnover (sales)}} \times 100 = \frac{3200}{5000} = 64.4\%$$

$$GPM \text{ (201 / 202)} = \frac{\text{Gross Profit}}{\text{Turnover (sales)}} \times 100 = \frac{3400}{5000} = 68.3\%$$

5. The net profit margin shows the firm's ability to control overheads and expresses net profit before tax as a percentage of turnover:

$$NM \text{ (200 / 201)} = \frac{\text{Net Profit}}{\text{Turnover}} \times 100 = \frac{5290}{5000} = 11.5\%$$

$$NM \text{ (201 / 202)} = \frac{\text{Net Profit}}{\text{Turnover}} \times 100 = \frac{2000}{5000} = 4.9\%$$

6. The Stock Turnover Ratio shows the number of times in a trading year a firm sells the value of its stock:

$$\text{Stock Turnover Ratio (200 / 201)} = \frac{\text{Cost of Sales}}{\text{Sales}} = \frac{17800}{(7500 + 8200) / 2} = 2.265$$

$$\text{Stock Turnover Ratio (201 / 202)} = \frac{\text{Cost of Sales}}{\text{Sales}} = \frac{22000}{(8200 + 9000) / 2} = 2.388$$

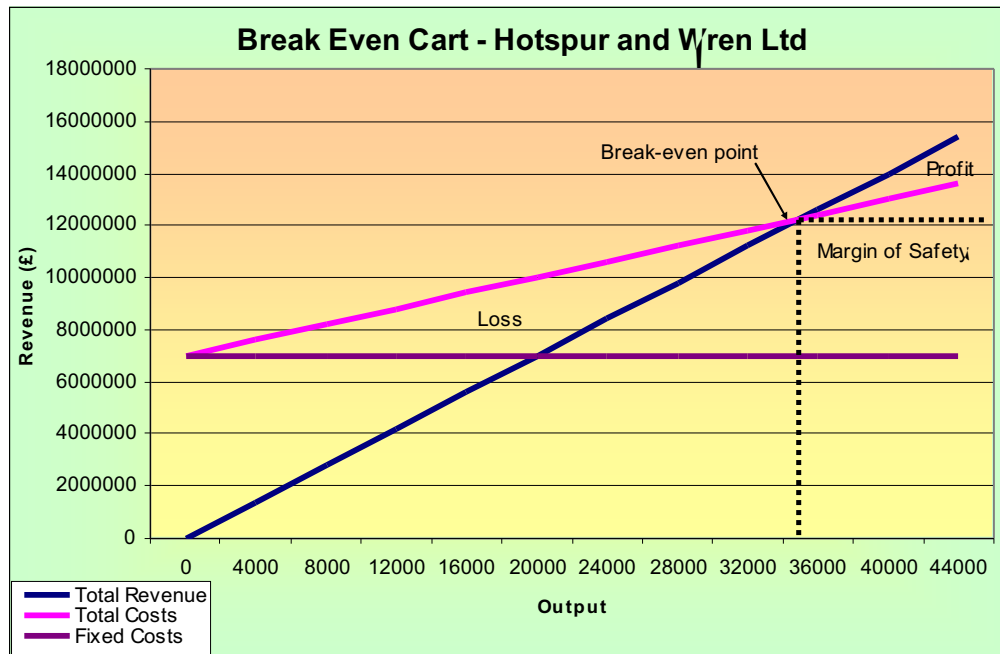
7. The business has significantly improved its profitability from a loss of (57,290) to a profit of 27,000. This is despite little or no change in the stated ratios. An examination of their expenses reveals that there has been a significant reduction in the General and Administration expenses. This could have been achieved by a reduction in staff costs by redundancy or a reduction in wages or a cost cutting program with expenses such as electricity or telephone. The reduction in expenses seems to have had little effect on the business's ability to earn revenue.

8. There is not detailed information in relation to the expense category. This means that John cannot assess how the reduction in expenses has been achieved, and how it may affect the business in the future. It would also be useful to view the balance sheet to assess in any change in liabilities has taken place which may impose additional interest expenses in the future.

Question 4

(a)

(b)



(c) The margin of safety in year 1 is an output of 35000 or revenue of £12250000.

(d) Year 1

SECTION 4 – MARKETING

4.1 THE MARKET

1. (a) The market – anywhere that buyers and sellers communicate to exchange goods and services
(b) Market orientation – an approach to business which places the requirements of consumers at the centre of the decision making process.
(c) Product orientation – The business focuses on the production process and the product itself when running the business.
(d) Marketing – The management process involved in identifying, anticipating and satisfying consumer requirements profitably.
(e) Market Segments – a section of the market, where markets are broken down into subgroups which share similar characteristics.
(f) Market Research – the collection, collation and analysis of data relating to the marketing and consumption of goods and services.
(g) Marketing strategy – this is a strategy incorporating the four P's and is designed to meet the needs of its customers.

2. A marketing strategy is a plan drawn up for a business to achieve its marketing objectives, as well as overall objectives of the company. A marketing mix requires the marketing mix to be considered. There are four parts to the marketing mix known as the four P's; Product, Price, Promotion and Place. To meet customers' needs, Hotspur & Wren Ltd have to provide the right product, at the right price, make it available at the right place, and let customers know about it through promotion.

Product – The goods Hotspur & Wren Ltd will be selling are carpets and furnishings such as curtains and soft furniture. To help determine success, Hotspur & Wren Ltd has to ensure that features such as quality, design, and comfort have been implemented in their goods. The appearance of the product will also be crucial to its success.

Price – There are various pricing strategies that can be implemented and the strategy a business employs usually reflects the market they are aiming at. Below are the possible pricing strategies:

- Cost Plus – cost of making product/ service + a set percentage (costs always covered)
- Penetration – low price to encourage customers (launching new product)
- Competition – based on prices charged by competitors for similar product.
- Skimming – selling at high price → sacrificing high sales for profits.
- Demand/ Supply – fixed by market price (where demand and supply cross).
- Promotional – sold at a loss to encourage purchases (promotion and price combined)

Promotion – Hotspur & Wren Ltd will need to communicate with their customers to make them aware that their products are for sale. They will explain to them what the product is, how it will serve their needs and persuading them to buy it the first time or again.

Place – Hotspur & Wren Ltd will have to locate their business where it will be most convenient and accessible to its market segment. The channel of distribution and method of distribution will also prove to be key factors in their decision of location.

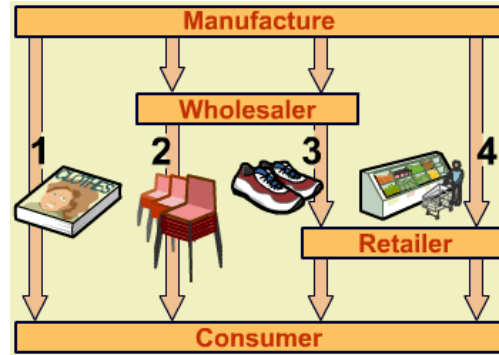
3. A promotional campaign will be essential to sell the products Hotspur & Wren Ltd offers to their customers. Firstly, Hotspur & Wren Ltd could advertise their product through the media. Today, there is a vast range of types of media such as television, magazines, posters, newspapers etc available.
4. Market research is the collection, collation and analysis of data relating to the marketing and consumption of goods and services. There are two main methods of market research. Field Research (collection of Primary data) involves the collection of data which does

not already exist. Questionnaires, interviews and Observation are good examples of Primary data. Desk Research (collection of Secondary data) is collection of data which is already in existence. It is normally used for a purpose other than for which it is collected. Government statistics, audit reports and such financial reports are good examples of secondary data.

5. Market Segmentation is the breaking the market down into sub-groups which share similar characteristics. There are various ways Hotspur & Wren Ltd can segment the market. Below are the various different methods of market segmentation:
 - Age – Hotspur & Wren Ltd customers are likely to be the working population.
 - Sex – This is not likely to be a segment for Hotspur & Wren Ltd's customers.
 - Level of education – e.g. for magazines who can target segments.
 - Socio-economic groupings – Groupings A-C, require money to purchase goods.
 - Income – High income groups, who can afford such luxury goods.
 - Religion – e.g. for Food Producers (Kosher food for Jewish)
 - Geography – area where customers live → likely to be near Hotspur & Wren Ltd.
6. As Hotspur & Wren Ltd is located in a highly competitive market, they are likely to use competition based pricing as they will be able to base their prices on the prices of their customers. Hotspur & Wren Ltd can base their products on prices charged by competing carpet and furnishing companies for the similar products. They will have to base their price not too high as customers will be lost to other competitors. However, if prices are set too low, customers will get an impression that the products for Hotspur & Wren Ltd are not of good quality. So Hotspur & Wren Ltd will have to analyse the market and its characteristics.
7. Promotion below the line refers to those promotional methods which do not depend upon media such as newspapers and TV. Instead, it takes place by methods over which firms have some degree of control. These include direct mailing advertisements, exhibitions and trade fairs etc. Below the line promotion allows a firm to aim its marketing at consumers it knows are interested in the product unlike in above the line promotion. Hotspur & Wren Ltd can hold sales promotions, free samples, competitions, gifts, point of sale after sales.
8. Hotspur & Wren Ltd can use point of sale promotion which is promotion at any point where a consumer buys a product.
9. There is a vast range of media to advertise in today's world. Below are the main media types:

| MEDIA | Advantages | Disadvantages |
|------------|--|--|
| Television | Large audience, shown many times, moving images, can be scheduled for target market. | Expensive, cannot look back (no hard copy), the adverts might be fast forwarded (on video) |
| Radio | Large audience, effect if target market local | Expensive, visual images cannot be used. |
| Cinema | Good effects motion, 'captive' audience, impact, age groups. | Limited audience ,might be only seen once, short lived message. |
| Newspapers | Can be read again, large audience, fairly cheap. | No sound |
| Magazines | | |
| Posters | | |
| Leaflet | | |
| Internet | | |

10. The Channels of Distribution is the route taken by the product as it passes from producer to the consumer. The producer of Hotspur & Wren Ltd's products can distribute their products to the consumers in several different ways. Firstly they could sell their products directly through the retailers, or wholesalers or through agents. Wholesalers buy in bulk from a manufacturer and then sell the stock in smaller quantities to retailers. The break-of-bulk point is the place, such as a warehouse where goods are unloaded. They are usually reloaded and transported elsewhere for sale.



11. Legal constraints on Hotspur & Wren Ltd in terms of marketing
12. The Consumer Credit Act (1974) will influence the operations of Hotspur & Wren Ltd as this act aims to protect the rights of consumers when they purchase goods on credit (e.g. hire purchase, credit sales). Hotspur & Wren Ltd will have to give the customers a copy of any credit agreement. They also have to be a licensed credit broker to sell goods and services on credit.
13. The internet is a fairly new media for marketing and it brings with it several advantages (and disadvantages).
14. The Advertising Standards Authority (ASA) is a voluntary body set up to monitor advertising in the UK. It is responsible for making sure that advertisers conform to the British codes of advertising and sales promotion practice. They state that the adverts must be legal, decent, honest and truthful and must not cause grave or widespread offence. Hotspur & Wren Ltd will have to comply with the ASA or the public issues complaints to the ASA.
15. Public Relations is an organisation's attempts to communicate with interested parties. The aim is to improve sales by improving the image of the firm and its products. Hotspur & Wren Ltd can use press conferences to attract publicity and press releases to convey activities and events that might be considered noteworthy. They might also make use of public relations by donating to charities and sponsoring sporting events etc.

SECTION 5 – PRODUCTION

5.1 ECONOMIES AND DISECONOMIES OF SCALE

1. Economies of scale are the reduction in cost gained by firms as they grow in size.
2. Internal economies of scale are the cost reductions enjoyed within a single firm as it grows. The five main internal economies of scale are technical, managerial, trading and financial economies of scale.

| Internal economy of scale | Definition |
|---------------------------|---|
| Technical | Made in the actual production of the good. For example, large firms can use expensive machinery, intensively. |
| Managerial | made in the administration of a large firm by splitting up management jobs and employing specialist accountants, salesmen, etc. |
| Financial | Made by borrowing money at lower rates of interest than smaller firms. |
| Marketing | Made by spreading the high cost of advertising on television and in national newspapers, across a large level of output. |
| Commercial | Made when buying supplies in bulk and therefore gaining a larger discount. |
| Research and development | Made when developing new and better products. |

External economies of scale are the cost reductions available to all firms as the industry grows. The main external economies of scale are location/ concentration of business, skilled labour availability and reputation of area.

3. Diseconomies of scale, on the other hand are rising long run average costs as a firm expands beyond its minimum efficient scale (scale of production). They might occur as businesses become too large to manage effectively. Individual departments may become more interested in promoting their own interests rather than of the business and might not work together on new projects. The whole organisation might also become too bureaucratic and service will not be able to be provided on a personal level.

5.2 METHODS OF PRODUCTION

4. **Job Production** - Method of production where a product is made individually from start to finish. Each product is likely to be different and unique. This process is labour intensive, requires skill labour and is very expensive (as tools are required). However, workers will also be more motivated and unique goods can be produced.

Batch Production - Method of production where a product is made in stages, with a particular operation being carried out on all products in groups or batches. In batch production can be monitored and there is flexibility in the amount produced. Little machinery is required.

Flow Production - Method of production where a product is made continuously, often through the use of an assembly line. Mass produced goods are most suitable for this type of production. This process has a small unit cost and the use of computer can reduce the labour requirements. The production method is capital intensive and costs a lot to set up.

5.3 PRODUCTIVITY

5. Production is the transformation of resources into goods and services, whereas productivity is the ratio of output to inputs in a production process.
6. Hotspur and Wren Ltd would benefit from an improvement in productivity as they could increase the efficiency of the business. Generally as a business increases its efficiency, profitability also increases.

7. The introduction of more machinery
8. Just in time production is a production system where stocks are only delivered when they are needed by the production system. This minimises stock levels in a business.
9. Electronic payment
10. CAD allows designers, engineers and architects to manipulate a 3D image. An image can be altered on-screen so the effects of any changes are seen instantly. This represents a huge saving in time and costs as a prototype need not be built at each stage. Customers can even design their own products and email them to the business. The products can then go straight into production.

5.4 QUALITY

11. Total Quality Management (TQM) is a method for a business to focus on quality by making it an important aim of every department and worker. If Hotspur & Wren Ltd uses TQM in its production process it will have a competitive edge over others as customers will be happier to purchase their goods as they are more likely to be free of defects. The product will also meet customers needs and