Topic 1 Section 3

Business Management

Contents

Introduction

This section provides an outline of the principles of business management. It describes the roles of the business cycle, capital, investment, expenses and profit. It is important for supervisors to understand these principles because they affect every part of the company's day-to-day operation. It is also important because, as a supervisor, you need to understand the relationship between the productivity and efficiency of the operation and the return on investment that the investors expect.

How a Business Works

The basic operation of any business is shown in the following diagram. Essentially, the way a business works is as follows:

- Shareholders provide money which they invest in a business.
- If the business is successful, it provides a profit.
- Some of the profit is handed back to the shareholders as a return on their investment.

Alternatively, the company may be owned by a private individual, a partnership, or some other legally recognised entity; in such cases, the profit is returned to the owner as return on investment.

There are three important points you should remember in this cycle. These are:

1. If the business is not successful, there will be either low profit or no profit.
2. If the profit is low or non-existent, the shareholders will not get a reasonable return on their investment.
3. If the shareholders do not get a reasonable return, they will eventually remove their support and the business will suffer accordingly.

As you can see, it is important for all within the company to ensure that they do their jobs well, so that the company is successful. It is important for supervisors to ensure that all personnel under their control are doing their jobs efficiently, to ensure that the company is successful.

During the day-to-day operations of any business, many issues may arise. The following sections describe these issues in more detail.

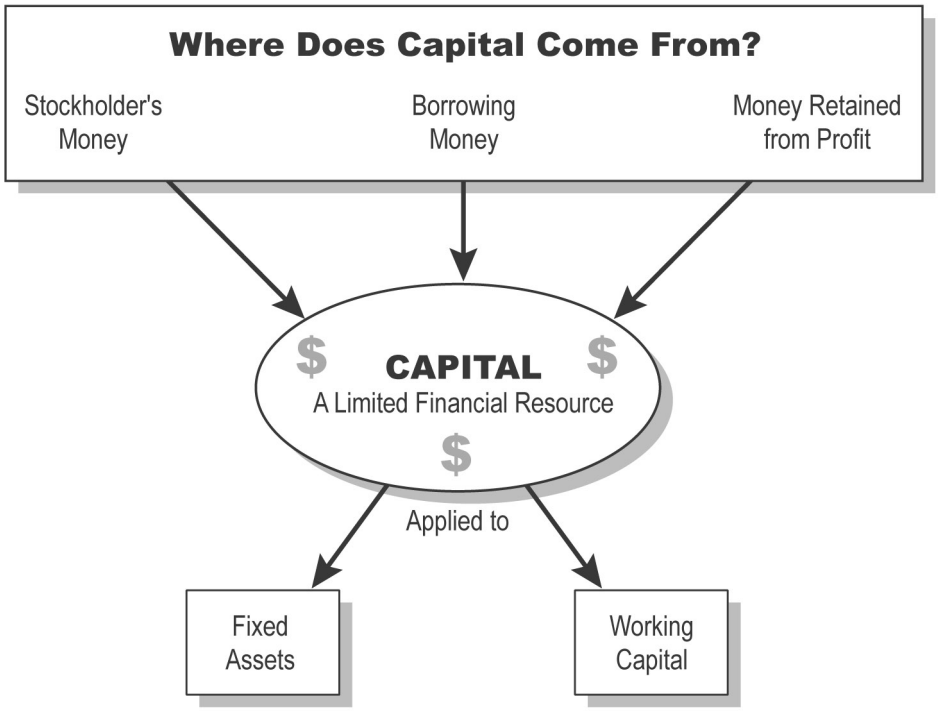
Capital and Working Capital

Any business needs money before it can operate. The money is generally known as capital. Capital can come from three sources. These are:

- Shareholders' money
- Borrowed money
- Retained profit (money that the company keeps from the profit).

Obviously, the amount of money available for any business operation is limited. Therefore it is important to ensure that it is not wasted. Capital can be used for two purposes:

- buy fixed assets
- provide working capital.



Fixed Assets

Fixed assets are items that are needed to operate the business. They can include:

- Buildings
- Computers
- Mobile equipment
- Office furniture
- Vehicles.

It is important to ensure that all equipment that is purchased adds value to the business. Equipment that does not 'pay for itself' is a waste of capital.

Working Capital

Working capital is money that is used to pay for the day-to-day running costs of the business. These include:

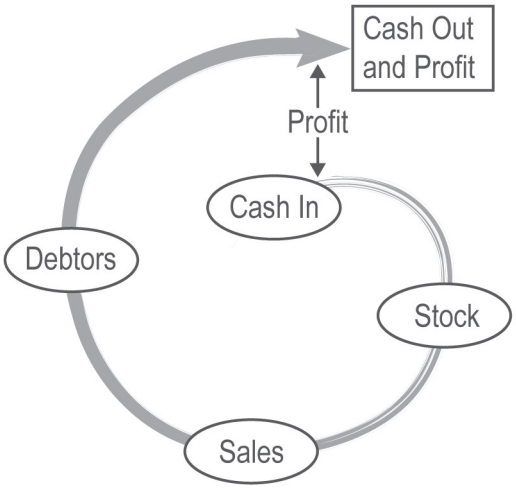
- Wages and salaries
- Fuel and oil
- Office equipment and supplies
- Materials.

Working capital is limited and cannot be wasted. All personnel and all materials that cost money must be necessary and must pay for themselves. If the business runs out of working capital, it will go broke. If the business goes broke, it can lead to a complete shutdown of operations and the loss of jobs.

Working Capital Spiral (Cash Flow)

The working capital cycle or cash-flow cycle operates like a spiral. The spiral works as follows.

1. The company puts money in.
2. The money is used to pay for labour and buy materials.
3. The labour and materials are used to carry out contract work.
4. The work is paid for by the client.
5. The money from the client is put into the spiral.
6. If the company is operating successfully, the money from the sales is greater than costs of production.
7. The difference between the cost of stock and expenses and the return from sales is profit.

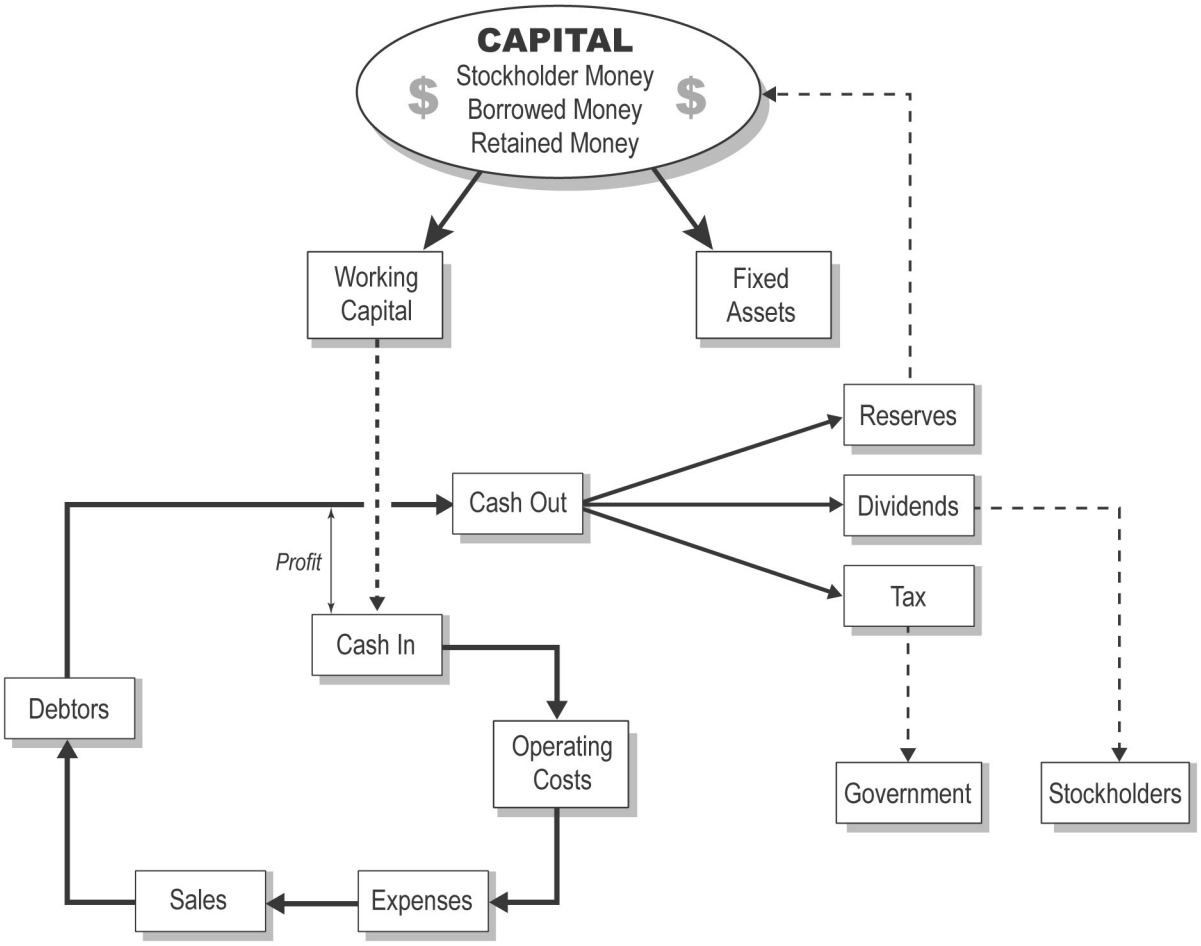


Note!
The profit can only be removed from the business at the end of the spiral.

The Business Cycle

The drawing below combines the two previous drawings, to show the business cycle, including the flows of money into and out of the working capital spiral. These include:

- Working capital flowing into the spiral
- Reserves (retained profit) flowing back to capital
- Dividends flowing to shareholders
- Tax flowing to government.



There are, however, other factors that must be taken into account. One of these factors is the amount that is returned to the shareholders. An acceptable profit level is determined by a number of things. There are two of these things over which the company has no control:

- Current interest rates for money
- Level of risk for the business.

Briefly, these two factors have effects as described below.

Interest Rates

Interest rates are the amounts that banks pay to borrow money, or that they charge to lend money. Interest rates are given as percentages and are continually changing world-wide.

When interest rates are high, they may affect a business in two ways:

1. The company's expenses increase because any borrowed money costs more.
2. The percentage of interest may become greater than the percentage of profit, in which case the investor will get a better return just by putting his money in the bank.

Risk

If the risk of business failure is high, investors seek a larger return on their investment. The larger return is to compensate investors for the fact that the business may fail, causing them to lose a large portion of their initial investment money.

Because of problems caused by interest rates and the business risk that cannot be controlled, it is very important to minimise wastage and maximise efficiency for those areas which we can control. The next section shows where things can go wrong in the business cycle.

Unnecessary Expenses

Unnecessary expenses are caused when money is spent on things that do not add value to the operation. In other words, unnecessary expenses equal wastage. When wastage occurs, it reduces the amount of cash that is available at the end of the spiral and can result in the operation making a loss instead of a profit.

Unnecessary expenses are a very important concern for supervisors in the construction industry. Expenses over which supervisors usually have a degree of control include:

- Labour
- Plant and equipment
- Materials
- Sub-contracts.

It is important to ensure in your day-to-day work that none of these resources is being wasted. If you allow resources to be wasted, you will be causing unnecessary expenses which will reduce profit, or lead to a loss.

There are three main areas where you, as a supervisor, can help to reduce these problems. These are through control, efficiency, and the minimisation of waste.

Control

You can minimise unnecessary expense through exercising control. In this case, control means:

- Using a process of checks and balances that focuses employees on all elements of cost control . In other words, making sure all employees understand where costs can cause problems and where costs can be reduced
- Using systems or standards that control spending
- Making sure all employees are aware of the costs of the resources they use (including their own time).

Most companies use a variety of controls that affect day-to-day work; as a supervisor you also need to make sure you use controls that are appropriate to your area of direct control.

Efficiency

Efficiency can be described as:

- Searching for, and implementing, better, cheaper, faster, or more effective ways of getting a task done. All supervisors should be constantly on the lookout for ways to improve efficiency.
- A balance between practicality and cost.
- The most cost-effective method of adding value to a process. In other words, always seeking to minimise the cost of any task we undertake.

Minimising Waste

Most people know when they are being wasteful with the resources they use. Waste can generally be described as:

- Unnecessary, unproductive, or excessive use of material, equipment, time, people or processes. When waste occurs, the company spends money and no results are achieved.
- Using resources when you have little or no awareness of their value.
- Entrusting work to people who are poorly instructed or poorly trained.

Values and Costs

It is important for construction supervisors to understand the implications that poor supervision and wastage— whether of resources (time, money, plant and equipment), or through poor work procedures or accidents— may have on the job or project.

An efficient supervisor, at any level in the construction organisation, will pay close attention to activities on and around the job. It doesn't take long for the effects of poor supervision or wastage to compound and have a large impact on time and costs.

The following table shows some examples of the impacts that wastage can have. The

contract is to move dirt at $4.50 per cubic metre, with the profit calculated at $0.40 per cubic metre.

Wastage example	Cost to job or project
Waste 100 dollars' worth of fuel	Move an extra 250 m^3 of dirt
Fined $300 for a breach of the *Workplace Health and Safety Act*	Move an extra 750 m^3 of dirt
Due to poor planning three dump trucks wait one hour for the excavator to be walked from another part of the job, at a cost of $140/hour	Move an extra 1050 m^3 of dirt
Pay three days' wages for a work-related injury at a labour cost of $30/hour = $900	Move an extra 2250 m^3 of dirt
Waste 500 tonnes of gravel due to poor checking of levels and inadequate control of shoulder, at $16/tonne	Move an extra 20 000 m^3 of dirt

Summary

This topic has provided a brief overview of the business cycle. The main points that should be remembered are as follows.

- Investors expect to get a profit on the money they invest.
- The business must operate efficiently to make a profit.
- Poor management and wastage will reduce efficiency and will lead to low profit or losses.
- When a business consistently makes a low or no profit, the shareholders will withdraw their support and the business may be forced to shut down with a loss of jobs.

As a supervisor, it is your job to ensure that the operation is efficient and that wastage is minimised. If you can achieve this, you will have gone a long way to ensuring that the company's operations have been profitable and that your job and the jobs of your fellow employees are secure.

Section 3 – Assessment Activities

For information on how these assessment activities may be used as part of the learning process, see the section on 'Assessment' in the 'Topic Descriptor' section at the front of this topic.

Theory Questions

The following questions allow you to assess your progress in understanding the material presented in Section 3. The questions may be of any of the following types:

- multiple choice (identify correct answer or answers)
- multiple choice (identify incorrect answer or answers)
- fill in the gaps in a sentence or statement
- identify a sentence or statement as TRUE or FALSE
- write a few sentences or a short paragraph.

Answers to the question are shown in the separate 'Answer' section.

Question 1

Place the following components of the business cycle into logical order:

Return on investment ☐

Stockholders ☐

Profit made ☐

Business is successful ☐

Business conducted ☐

Invest in company ☐

Question 2

What is likely to happen if business is not successful?

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Question 3

What role do company employees on-site play in the business cycle?

Question 4

Define the following terms:

Capital

Assets

Liabilities

Working capital

Question 5

What is the basic requirement when buying new equipment for a business from the working capital?

Question 6

Place the steps of the cash flow spiral in order:

- The money is used to pay for labour and buy materials. ☐
- The difference between the cost of stock and expenses and the return from sales is profit. ☐
- The company puts money into a project. ☐
- The contractor is paid by the project's principal. ☐
- The money earned from the project is put into the spiral. ☐
- The labour and materials are used to complete the project. ☐
- If the company is operating successfully, income from completing a project will be greater than the cost of construction. ☐

Question 7

How can interest rates affect a business?

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Question 8

Define risk and give example of different types of risk.

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Question 9

What are unnecessary expenses?

Question 10

How can a supervisor reduce the cost of unnecessary expenses?

Question 11

Define 'efficiency'.

Question 12

How may supervisors increase efficiency?

Question 13

How can supervisors minimise waste?