NATIONAL OPEN UNIVERSITY OF NIGERIA

BUS 428

Business Policy and Strategy

Module 3

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Module 3

Unit 1 Basic Policy Areas

1.0 Introduction

Changes in a firm's strategic direction do not occur automatically. On a day-to-day basis, policies are needed to make a strategy work. Policies facilitate solving recurring problems and guide the implementation of strategy. Broadly defined, policy refers to specific guidelines, methods, procedures, rules, forms, and administrative practices established to support and encourage work toward stated goals. Policies are instruments for strategy implementation. Policies set boundaries, constraints, and limits on the kinds of administrative actions that can be taken to reward and sanction behavior; they clarify what can and cannot be done in pursuit of an organisation's objectives. For example, Conoil plc has a no smoking policy anywhere, anytime within company premises. Another example of corporate policy relates to surfing the Web while at work. About 40 percent of companies today do not have a formal policy preventing employees from surfing the Internet, but software is being marketed now that allows firms to monitor how, when, where, and how long various employees use the Internet at work.

2.0 Objectives

At the end of this unit, you should be able to:

- explain the hierarchy of policies
- highlight and comment on the gamut of policies that support a company strategy
- identify the different organic functions of a business with basic policy outlook.

3.0 Main Content

3.1 Policies that Support a Company Strategy

Speed is a critical necessity for success in today's competitive, global marketplace. One way to enhance speed and responsiveness is to force/allow decisions to be made whenever possible at the lowest level in organisations. Policies are broad; precedent-setting decisions that guide or substitute for repetitive or time-sensitive managerial decision making. Creating policies that guide and "preauthorise" the thinking, decisions, and actions of operating managers and their subordinates in implementing the business's strategy is essential for establishing and controlling the ongoing operating process of the firm in a manner consistent with the firm's strategic objectives.

Policies let both employees and managers know what is expected of them, thereby increasing the likelihood that strategies will be implemented successfully. They provide a basis for management control, allow coordination across organisational units, and reduce the amount of time managers spend making decisions. Policies also clarify what work is to be done and by whom. They promote delegation of decision making to appropriate managerial levels where various problems usually arise. Many organisations have a policy manual that serves to guide and direct behavior.

Policies can apply to all divisions and departments (for example, "We are an equal opportunity employer"). Some policies apply to a single department; employees in this department must take at least one training and development course each year. Whatever their scope and form, policies serve as a mechanism for implementing strategies and obtaining objectives. Policies should be stated in writing whenever possible. They represent the means for carrying out strategic decisions. Examples of policies that support a company strategy, a divisional objective, and a departmental objective are given in Table 1.1 Some example issues that may require a management policy are provided in Table 1.2

Table 1.1: A Hierarchy of Policies

Company Strategy

Acquire a chain of retail stores to meet our sales growth and profitability objectives.

Supporting Policies

1. "All stores will be open from 8 A.M. to 8 P.M. Monday through Saturday." (This policy could increase retail sales if stores currently are open only 40 hours a week.)

2. "All stores must submit a monthly control data report." (This policy could reduce expense-to-sales ratios.)

3. "All stores must support company advertising by contributing 5 percent of their total monthly revenues for this purpose."(This policy could allow the company to establish a national reputation.)

4. "All stores must adhere to the uniform pricing guidelines set forth in the company handbook." (This policy could help assure customers that the company offers a consistent product in terms of price and quality in all its stores.)

Divisional Objective

Increase the division's revenues from $10 million in 2009 to $15 million in 2010.

Supporting Policies

1. "Beginning in January 2010, each one of this division's salespersons must file a weekly activity report that includes the number of calls made, the number of miles traveled, the number of units sold, the dollar volume sold, and the number of new accounts opened." (This policy could ensure that salespersons do not place too great an emphasis in certain areas.)

2. "Beginning in January 2010, this division will return to its employees 5 percent of its gross revenues in the form of a Christmas bonus." (This policy could increase employee productivity.)

3. "Beginning in January 2010, inventory levels carried in warehouses will be decreased by 30 percent in accordance with a just-in-time (JIT) manufacturing approach." (This policy could reduce production expenses and thus free funds for increased marketing efforts.)

Production Department Objective

Increase production from 20,000 units in 2009 to 30,000 units in 2010.

Supporting Policies

1. "Beginning in January 2010, employees will have the option of working up to 20 hours of overtime per week." (This policy could minimise the need to hire additional employees.)

2. "Beginning in January 2010, perfect attendance awards in the amount of $100 will be given to all employees who do not miss a workday in a given year." (This policy could decrease absenteeism and increase productivity.)

3. "Beginning in January 2010, new equipment must be leased rather than purchased." (This policy could reduce tax liabilities and thus allow more funds to be invested in modernising production processes.)

Table 1.2: Some Issues that May Require a Management Policy

- To offer extensive or limited management development workshops and seminars
- To centralise or decentralise employee-training activities
- To recruit through employment agencies, college campuses, and/or newspapers
- To promote from within or to hire from the outside
- To promote on the basis of merit or on the basis of seniority
- To tie executive compensation to long-term and/or annual objectives
- To offer numerous or few employee benefits
- To negotiate directly or indirectly with labor unions
- To delegate authority for large expenditures or to centrally retain this authority
- To allow much, some, or no overtime work
- To establish a high- or low-safety stock of inventory
- To use one or more suppliers
- To buy, lease, or rent new production equipment
- To greatly or somewhat stress quality control

- To establish many or only a few production standards
- To operate one, two, or three shifts
- To discourage using insider information for personal gain
- To discourage sexual harassment
- To discourage smoking at work
- To discourage insider trading
- To discourage moonlighting

Policies often increase managerial effectiveness by standardising routine decisions and empowering or expanding the discretion of managers and subordinates in implementing business strategies. Since each company has its own unique strategy, its policy will also be individually tailored. However, virtually every firm faces a similar set of issues, and an analysis of policy can be expedited and improved by a systematic exploration of these basic issues. A convenient sequence for analysis is:

1. Marketing policy – product line and customers
2. Research and development policy,
3. Financial policy
4. Production policy
5. Human resources
6. Procurement policy

4.0 Conclusion

Within the general framework created by the business's generic and grand strategies, each business function needs to undertake activities that help build a sustainable competitive advantage. These short-term, limited-scope plans are called functional tactics. A radio ad campaign, an inventory reduction, and an introductory loan rate are examples of tactics. Managers in each business function develop tactics that delineate the functional activities undertaken in their part of the business and usually include them as a core part of their action plan. Functional tactics are detailed statements of the "means" or activities that will be used to achieve short-term objectives and establish competitive advantage.

5.0 Summary

The selection of the best strategic alternative is not the end of the strategy formulation. Management now must established policies that define the ground rule for implementation. Flowing from the selected strategy, policies provide the guidance for decision making an action throughout the organisation. Policies tend to be rather long lived and can even outlast the particular strategy that created them.

6.0 Self-Assessment Exercise

From the practical experience of your present company, provide five on – the – spot examples of issues that may require a management policy in each of the organic functions of your company.

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Unit 2 Marketing Policy

1.0 Introduction

Marketing of late has become more about building a two-way relationship with consumers than just informing consumers about a product or service. Marketers today must get their customers involved in their company web site and solicit suggestions from customers in terms of product development, customer service, and ideas. The online community is much quicker, cheaper, and effective than traditional focus groups and surveys. Countless marketing variables affect the success or failure of policy and strategy implementation, and customers trust each others' opinions more than a company's marketing pitch, and the more they talk freely, the more the firm can learn how to improve its product, service, and marketing. Customers must not feel like they are a captive audience for advertising at a firm's Web site. Table 2-1 provides new principles of marketing according to Parise, Guinan, and Weinberg. This is opening up even larger markets to online marketing.

Table 2.1: The New Principles of Marketing

1. Don't just talk at consumers—work with them throughout the marketing process.
2. Give consumers a reason to participate.
3. Listen to—and join—the conversation outside your company's Web site.
4. Resist the temptation to sell and sell. Instead attract and attract.
5. Don't control online conversations; let it flow freely.
6. Find a "marketing technologist," a person who has this, three excellent skill sets marketing, technology, and social interaction.
7. Embrace instant messaging and chatting.

Source: Newman, H.N; Logan, J.P & Hegarty, W.H (1985). *Strategy, Policy and Central Management.* (9th ed.). USA: South -Western Publishing Company

2.0 Objectives

At the end of this unit, you should be able to:

- comment on the different dimensions of product line policies
- highlight and explain the scope of customer policies
- discuss issues involved in the marketing mix policies
- describe the specific issues by a company pricing policy.

3.0 Main Content

3.1 Marketing Policy

The broad policy of any manufacturing business will no doubt state in general terms what it intends to produce and hopes to sell. It will for example, make it clear that it is intended to produce machine tools and not electrical components. If, however, the policy is to succeed, considerable though must be given and many decisions taken, by the marketing director (or manager) and other responsible for its implementation.

The main considerations upon which a working marketing policy may be based include:

1. Profit Planning

Where a budgetary control system is employed, the whole structure of the budget and therefore, of the policy may be based upon a planned profit.

1. Sales Volume

In order to achieve the volume of sales must be estimated. This may introduce many problems which in a large organisation will require considerable market research.

2. Market Research

Thorough study of the market will provide answers to most of the problems. Properly conducted, the research will reveal the present and future potentialities of the market.

3. Sales Promotion

Having ascertained the market potential, planning must then be directed towards promoting sales to the level necessary to earn the planned profit. In order to achieve this objective, advertising, public relations and perhaps other subsidiary policies will be formulated and treated as the separate responsibilities of managers within the marketing group.

Sales

The selling and distribution of the goods produced are usually treated as a separate department; that is, they are usually separate from the public relations and sales promotion (or advertising) departments. They are, nevertheless, an essential part of the marketing team and will probably be responsible to a marketing manager or marketing director.

3.2 Product Line Policy

Usually a company strategy defines the type of product or service offer for sales, but does not provide answers for the following questions:

1. How many different sizes, grades and shapes of the product will be carried in the line?
2. How can our products be made distinctive from those of competitors?

3. Should we change product design frequently say every yearly or stick with a tested model?

We need standard on such issue (e.g. policy statement) for two reasons: Firstly, to build a desired and consistent interpretation of strategy and Secondly, because many marketing, production and financial activities will be affected by the simplicity or the elaborateness of the company's product line.

1. Variety of Product

It is expected that for each strategic market or niche, a company must decide what variety of products will be offered to its customers. The decision on variety is a reoccurring and often controversial as markets change, competition grows and new technology becomes available.

a. Cost Diversity

Customers are continually demanding for products that are smaller, stronger or otherwise different from what is offered and sales representatives may content that sales volume could be increased if they had larger variety of product to sell. One way of dealing with this recurring controversy is to fix a limit on the number of items. Then any proposal for a new item must be accompanied by a recommendation to drop an existing one in place of the new. Having such a policy has the advantage of forcing attention to pruning along with justifying the new item.

b. Need for Complete Line

Sometimes the customers want to buy a variety of products from the same source. For example when buying ingredients for tea you may need sugar, bournvita, milk etc. therefore, providing a complete line of products in very important. In contrast, a policy that concentrate on only a few items may be wise for a firm seeking distinction as a specialist e.g. Zaria Industry Limited – produces only Tarpaulin. By focusing on a narrow line, costs can be reduced, and if the product is sold in large enough unit to warrant separate action by customers, the lack of a complete line may be no serious handicap. A narrow line policy relies on specialisation to achieve a competitive advantage in pricing, unique service or concentrated attention.

c. Ways of Customising

Providing some variety can be offered without adding too much cost. Common practice with automobiles, refrigerators, kitchen equipment etc, they have standard products in two or three sizes, with other options to choose from, such as colour and accessories. The number of variations is strictly limited, and the optional items are available only at an additional cost to the customer. This practice helps in giving customers choices to make.

2. Product Differentiation

Variety of products is one way of having differential advantage. A less costly way is to produce products of high quality as meeting the need of the customers. The basic question in product differentiation is how to make a company's products distinctive from competitors. This is necessary for a company that wants a continuing and consistent reputation in the market and to guide its engineers and production people on what to emphasis in their products.

a. Quality

This can be defined as relating to terms such as durability, appearance, purity, dependability etc. a company that seeks distinctiveness on the basis of product quality. It must decide the particular characteristics it will stress. In this case the desired market segmentation is the key in setting policy.

b. Consumer Recognition of Product Differences

In deciding on the kind of distinctiveness to emphasis, the company must consider not only the desires of its customers but also their ability to appreciate variations in quality. The company must therefore determine:

1. What characteristics of its product customers feel are important?

2. The extent to which its customers can appreciate the differences in such features and how much they are willing to pay for this extra quality and;

3. Whether the cost of producing extra features is more or less than customers are willing to pay for them.

3. Frequency of Design Change

How frequent changes in design should be made depends on the following;

a. Cost of Change

Mostly design changes are costly as it relates to technical and marketing research, engineering, testing and tooling-up for the redesigned product. Cost tend to increase if frequents changes are made, because new skills have to be learned, production runs are shorter and overhead builds – up other areas that such changes may affect are: Inventory, distribution – wholesalers and retailers, service problems (repair) and promotion.

b. Pressures to Change

The pressures of style or technology are strong by themselves because new developments are occurring every year affecting most products. Therefore, competitors' actions may make the need to change irresistible. For example, when a preferred product is offered by a competitor, a company must respond by redesigning its own product for the market.

c. Frequency of Change

Several alternative ways of recognise the pressures and the costs of redesign of products:

1. Annual Model - mostly use for consumer goods

2. "Product Leadership-" This is a Policy in which the firm wants to first on the market with improvements and new designs are introduced as rapidly as new technology is developed

3. Leap front Approach- In this approach once a company has a good design; it sticks with it without minding competitors various modifications that may not be too significant. But when significant improvements are evident them such a company may make major adjustment, incorporating competitors' advances as well as their own. The presumption here is that production and marketing economies of few changes will more than offset a temporary lag in improvement. This policy is best in fields where technological change has been slow.

4. Product Line policy of a Service Company

Standard answers must be given to the following questions.

- What variety of course should it offer?

- How should it differentiate its services from other institutions?

- What characteristics of quality are significant and can the consumer recognise the differences?

- How frequently should programs change?

3.3 Customer Policy

Customer policy is broadly determined by the company's strategy regarding the domain but it needs further elaborations and refinement before it gives adequate to daily decision making. Three important areas of decisions are:

1. What group of ultimate consumers does the company which to serve?

2. What channel of distribution will be most effective in reaching this consumer?

3. What limits on size or other characteristics should be placed on customers with whom the company deals directly? Correct answers to these question based on its capability establish the policy on customer.

1. Consumer Sought

In this case a company needs to distinguish its customers from the consumers of its products. The consumers are those who use a product or service for their personal satisfaction or benefits and in the case of industrial products, are firms that change the form of the products or alter its identity into something more useful. While a customer on the other hand are persons who buy goods (product). A customer can be a consumer or dealer who will resell the product to someone else.

It is a fact that all businesses are most interested to know the habits and wishes of the ultimate consumer, because the major purpose of any economic activity is to create consumer satisfaction. Therefore, right from the original design of the product, through its production, and distribution, consumer satisfaction in ever a controlling factor. Consequently, a policy is necessary to clearly define the "Segments" of consumers sought to be served with the company's product (services), even though the company may use middlemen to actually sell to those consumers.

a. Types of Consumers

Different kinds of consumers want products or services of various natures. It is the company's business to identify its type of consumers i.e. people who consume its products. The relationship between a company and consumers or its products is normally continuous over a period of time. During this period, reputations are established and expectations and these are vital to careful planning and are built up. Therefore, a company cannot move in and out of a market from week to week. Instead, well-established and relative stable policies regarding consumers to be served are very useful.

b. Location of Consumers

A company should be able to precisely know where its consumers are whether in the rural or urban areas; whether they are a particular tribe or settlers etc. same is expected if the company exports its products to foreign markets, the location either by country or as mentioned earlier need to be specified. Companies that wish to make full utilisation of an existing strength adopt a national distribution; because national advertising of the company already necessary for part of the market and is reading consumers in all areas, therefore the question of location may be nationally.

Also competitive tactics may influence policy regarding location of desired consumers. For example, company **A** may immediately follow B into a new area because **A** does not want B to acquire a possible source of strength that might be extended to other marketing. Another reason for such an action could be if the area is considered to be a very viable market area. On the other hand, where territorial patterns are aired in place as a market for every company, some may not move into others market territories for fear of how they are likely to reciprocate their action. Such reasons may result in a firm pushing its territorial limits just to the point where incremental selling and delivery costs match incremental revenue.

c. Consumers of "Small Business

Over the years small businesses usually catered or serve local consumers. Nowadays, improvements in transportation and communication have however, affected the consumers of small businesses because companies that distribute nationally now reach even the remotest consumer in the villages. Likewise local semi monopolies are fast disappearing.

Therefore, most small businesses are now seeking for more ways of distinguishing their products and services, while attempting to expand the geographical location of their potential consumers.

2. Channels of Distribution

This means the steps by which products are distributed from the manufacturers to the consumer. In the case of services e.g. banks, airlines and all sorts of retail stores, such services are mostly sold directly to consumers. But for manufacturers of goods, they have to select proper channels of distribution which is usually a big problem.

Changes in buying habits, transport, communications, and market locations have modified methods of distribution greatly in these recent years. This whole field is in a state of flux, and few companies are justified in assuming that their traditional channels are still most effective ways of reaching the consumer. The farsighted choice of the right channel of distribution sometimes becomes a major "differential advantage".

i. **Through Jobber (Wholesalers)**: this is regarded as the orthodox method of distribution. The wholesalers usually assemble products from many manufacturers, store them and sell them to retailers. By so doing, they also assume risks of price change damage or obsolescence, they extend credit to retailers and they sort and ship products according to retailer's needs. All of these functions are essential in the distribution of merchandise: regardless of the channel of distribution used, someone must perform them. The use of wholesalers is of necessity and economical to the large number and scattered over a wide territory than to undertake to serve them directly. For other obvious reasons, some manufacturers set up distribution system which deals directly with them. The problem of using wholesalers to manufacturers is the fact that they add at least 20 to the selling price of the products.

ii. **Direct to Retailers**: direct distribution to retailers has some distinct advantages. By using its own sales representatives to call on retailers, the manufacturer may secure more aggressive selling efforts; as oppose to a jobber who sales a wide variety of products and so can concentrate of the sale of any single product. Dealing with the retailers may enable a manufacturer to ascertain better, the consumers' desires because they deal with them also directly. The manufacturer exercise more control over the final sale of its products. Personal relationships and good will are established that will enhance better dealings with one another. The manufacturer can influence retail prices, display and even have the retailers to handle only his products. Despite all the above advantages, an overstretched use of selling to retailers may lead to excessive costs and therefore may be unwise. On the alternative, companies that product a variety of goods may set up their own sales branches. And these branches operate like jobber, except that they handle only the parent company's products.

iii. **Direct to Consumers**: this method is used for most technical products and so sales persons are trained to sell such product. Likewise industrial equipments are sold directly to users. Some companies use Exclusive dealers for example automobile manufacturers and oil companies, they combined many advantages of direct sales to consumers while retailer the initiative of local business people. The dealer operates his own business but must join in company sales programmes and conform to service standard set by the company. The company must have variety of products to enable them make profit.

iv. **Through Brokers or Agents**: the broker only performs one major function of the distribution which is selling. The Agent connects the buyer and selling or manufacturer.

v. **Selecting a Channel of Distribution**: according Dr. Thomas L. Berg, is an organisational problem and the activities of the total system of distribution should be analysed as follows:

a. List all activities necessary between producer and consumer e.g. promotion, actual selling, transportation, financing, warehousing repackaging, transportation, financing, warehousing repackaging, risk-taking, installation and repair services etc.

b. Group these activities into jobs that can be efficiently and effectively performed by separate firms.

c. Define relationships between the jobs that will ensure cooperation and necessary flow of information. Also define the compensation and controls over those firms that will perform the jobs.

d. Based on the policy of the company design specification for the firms that are to fill each job.

e. For execution, recruit the people to take the specified jobs, educating them on how the jobs are to be carried out, supervising the day-to-day operations and exercising necessary controls.

Since a channel of distribution typically creates a complex set of relationships, a policy is needed to provide consistency and stability of action.

3. Size of Customers

Customers that buy from a company directly buy in quantities, they either buy too small or too large. The company should know how much it costs to serve each type of customer and the amount the consumers must buy if their business is to yield a profit to the company. A close analysis of the size of customer may help the company eliminate some as well as reducing its sales staff.

To eliminate too small quantity producing their future potential should be assessed. Likewise, a company must not depend on just few purchasers of too large quantities, for example on one or two for most of its business, doing so make its position vulnerable because a loss of patronage of one such buyer will affect the entire organisation e.g. companies in the aerospace industry.

3.4 Marketing Mix Policy

The strategy of a company identifies the domain it seeks – its industry and preferred market niche(s). The product and customer policy do expand and specific the marketing effort necessary to satisfy the consumer. The consumers do not merely buy physical products; instead, they purchase a package that fulfills their needs that provides a psychological pride of ownership and/or consumption, that involves minimum anxiety about breakdown or damage that is considered "good buy at the price" that is acquired without great financial burden, that is delivered when wanted and in good condition. In essential part of marketing is for the company to conceive of a practical package of satisfactions that will appeal to a reasonable number of consumers.

Therefore, an attempt to provide these consumer satisfactions involves costs. These costs may be made up of direct expense incurred by the producer of it may be a free or margin charged by distributors, keeping these costs within acceptable limit is, of course, an important aspect of designing a viable package of satisfaction (or marketing mix) for consumers.

The marketing mix policy in addition to the package of satisfactions, seek how to communicate with consumers to present the offer. To achieve this, alternative forms of advertising must be available; and advertising and sales staff cost money. Nevertheless, a choice must be made as to how much of each consumer services, higher quality, convenient packages, lower price, advertising or personal solicitation should be offered and at what cost? This allocation among such competing uses account for the distribution costs in the marketing mix.

And such a marketing mix is required for each of the product of a given company in order to make appropriate offer to each product – market. Therefore basic policies to be determined with respect to marketing mix must centre among the follows.

1. Lean low - cost approach versus a full service approach.
2. Sales appeals to be emphasised.
3. Sales promotion in support of selected appeals.

1. Lean Low-Cost Approach versus Full-Services Approach

These approaches control on total effort and expense to be added to the product or service package offered to consumers. The company must decide on either selling a naked physical product at a low cost or adding some services at an additional cost for more complete consumer satisfaction.

In this case the selling bargain - basement approach need not mention that no services will be provided, but is does imply that in production, as well as in marketing expense will be minimised. Such a low expense policy may restrict marketing mix options.

Most companies do start with low prices and later shift are made to add some vital services at an additional expense. Therefore operate a low-expense policy should be a steady state except if the consumers dictate so.

2. Sales Appeals to be Emphasised

Among important sales appeals a company may choose from (sooner or later) are:

a. Associated Service

b. Quality

c. Style and Packaging

d. Company Reputation, and

e. Pricing.

Except for style and packaging these appeals can be used in companies that offer services as well as physical products. Also they are usable by both small and big companies.

a. Associated services may include:

a. Personal assistance

b. Maintenance and repair

c. Installment on credit

d. Prompt availability (prompt services or delivery etc.)

e. Training of operation in the buying organisation.

b. Quality as a sales appeal: Quality higher than the usual prevailing level can be used as part of the marketing mix. Note that extra quality involves extra effort and cost. A policy to build extra quality into a company's products must match up against other ways of differentiating a total marketing mix. The important question is: does distinctive quality hold strong appeal to the particular customers the company is trying to reach? Using quality as a sales appeal has a limitation if consumers are unable to detect the difference, and may be skeptical about the claims made. To enhance the use of this appeal some companies as a matter of policy do guarantee their products.

c. Emphasis on style and packaging: The degree of emphasis on Styles in the total selling effort may be a significant policy. Adhering to styles add to the design and production expense and to have currently popular styles and colour? Packaging is one means of giving a product stylish appearance and an important role in the marketing mix. Packaging can affect the product service itself.

d. Place of a company's reputation in marketing mix: Service organisation emphasis reputation as one of the strong appeals in the marketing mix e.g. Banks, Insurance companies etc. Likewise, a well-regarded and generally accepted brand name is so important in the sale of large number of products for the same company. Even the competitive bidding process of government makes allowance for company reputation. A low bid may be rejected if the bidder lacks a demonstrated ability to perform.

Good reputations are not bought in the market, but they arise primarily from a sustained willingness to devote extra effort to assure dependability and use of the latest state of the art, to avoid exaggerated claims. So since to develop and maintain a reputation is inconvenient and costly, a policy on the kind on reputation the company desires is necessary e.g. If a company has earned a distributive reputation, then it is appropriate to reinforce this posture publicly and to incorporate it in total marketing effort.

3.5 Pricing Policy

Pricing: All of the above sales appeals add to boost company expenses. A price of a product is made up of such expenses, cost and the percentage of profit to be earned if any. Pricing itself is often presented as a sales appeal.

A pricing policy should fit with other company policies and strategies in three important ways:

1. Pricing should be related to costs

2. Pricing should be related to competitor's prices

3. Price should be related to consumer's use of the product.

3.5.1 Price should be related to Cost

1. When selling unique products or service such as market research data etc. charging cost plus a customary mark-up is the usual policy. This is usually based on the relationship between the company and its customers – trust and confidence of fair dealing in terms of the price charge. For standardised products of services, if the company is in a favourable position of being a low-cost producer in the industry, it may the prices to total – costs in order to discourage new entrants. Often these firms lower their prices as their prices as their costs go down – partly to tap new markets but also to ward off competitors. Setting prices to cover total costs (including a normal profit) provide a comparable internal discipline. If a product cannot be sold at a price that earns its keep, then that product can be dropped.

2. This policy assumes that resources devoted to producing the product are transferable to more rewarding ventures. Also when part of the costs are fixed, that is, cannot be cut out or transferred to other uses, - the price may be dropped below total costs provided the income received makes some contribution to these fixed costs.

3. Relating prices to competitors' prices: For small firms a common policy is to set a price close to that of a leading company or the industry standard. In this case price is removed as a competitive factor in selling. Price is often used as a prominent part of the marketing mix. In such a situation prices are set low relative to competitors. Or a temporary price cut may be part of a special sales promotion-such is (defensive) action. Also in relation to competitor's prices, some companies as a policy choose to keep their prices within 10% or 20% of competitor's prices.

4. Prices recognising customers' use of the product: Different customers may be charge different prices e.g. selling to wholesalers and retailers, the wholesaler receives extra discount in recognition of its work of storing, selling and financing. Another example is that factories pay lower prices for electricity than household user. In all these examples, one can see how pricing an integral part of each marketing mix is. In deciding on the combination of appeals that are likely to be effective, judgment should be based on their

differences in attractiveness of various appeals to the customers as well as their compatibility and perhaps synergistic effect of a particular appeal policy with the product market emphasis.

3. Sales Promotion I Support of Selected Appeals

Sales promotion in the marketing mix is very important for that fact that selected sales appeals e.g. a low price policy need to be communicated to the target customers. This can be done with various kind of advertising and personal solicitation. Because of the availability many forms and degrees of such promotional effort, policy guidance is needed.

A. Advertising: because of the presence of different form of advertising whether you walk, drive, ride a bus, watch television, read newspapers of magazine, or open mail one faces one form of advertising or the other. This creates difficulty to management. Major questions to solve problems of selecting an advert are:

a. The purpose for which the advertising is to be used.

b. The media employed to accomplish these purposes.

i. Purpose of advertising is:

- Bringing customers to the place where goods are sold.

- Persuading the customers to ask for a specific product.

- Assisting sales representatives in making sales when calling on customers.

- Producing direct sales via mail or telephone.

- Building institutional goodwill.

ii Choice of Advertising Media is:

Television	Newspapers
Radio	trade papers
Magazines	direct mail etc%

Also others are displays, dealer-help and sampling. The choice of media evolves from selecting between economy and effectiveness in reaching objectives. For small companies with limited budgets, media choice is strongly influenced by what competitors are doing.

B. Personal solicitation: sales representative have a role in most selling transactions,

i. Differences in the use of sales representatives which should largely depend on their field of specialisation e.g. for selling industrial product.

ii. An analytical approach- attempts to determine what role sales representative should play as well as relating such roles to the marketing mix.

The following questions may be helpful?

1. Who consumes the product or uses it?
2. Who makes the final decision to buy?
3. What factors influence the decision maker?
4. How can the company influence those factors by means of varying the marketing mix?

C. Need for synergy this is to say that no single factor of the marketing mix makes a sale. Therefore, they must not be treated as separate part instead each part should complement the other in a synergistic way. Likewise, sales promotion and other policies should be synergistic and such a combination should fit the basic mission of the company.

4.0 Conclusion

Although the marketing domain part of company strategy defines the type of product or services to be sold, rarely does it provide answers to questions such as how many different sizes, grades and shape of the product will be carried in the company product line. For example Peugeot automobile Nigerian (PAN) Ltd. decided at strategic level to go into automobile hence the business went into the automobile production.

But it doesn't say what type of automobile – big, small, luxurious or different brands and sizes etc. that it will produce. Therefore in deciding on the combination of appeals that are likely to be effective, judgment should be based on their differences in attractiveness of various appeals to the customers as well as their compatibility and perhaps synergistic effect of a particular appeal policy with the product market emphasis.

5.0 Summary

The consumers do not merely buy physical products; instead, they purchase a package that fulfills their needs that provides a psychological pride of ownership and/or consumption, that involves minimum anxiety about breakdown or damage that is considered "good buy at the price" that is acquired without great financial burden, that is delivered when wanted and in good condition. In essential part of marketing is for the company to conceive of a practical package of satisfactions that will appeal to a reasonable number of consumers.

6.0 Self-Assessment Exercise

Customer policy is broadly determined by the company's strategy regarding the domain. Amplify this statement.

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Unit 3 Production Policy

1.0 Introduction

Company strategy involves effective integration of supplies of goods or services with their marketing. Many firms have separate department of purchasing and production but the basic problems that demands attention of the central management are so entwined that it is simpler to consider production policy and purchasing policy together. In a manufacturing concern, purchasing is directly linked with production because of the raw materials that is involved.

Major production and purchasing, policy issues centered on the following:

1. Deciding the extent to which vertical integration is strategic.
2. Selecting the general processes to be used in production.
3. Setting total capacity and facility balance
4. Providing basic guide for maintenance and replacement.
5. Resolving make-or-buy questions regarding services and supplier
6. Selecting vendors from whom purchases should be made.
7. Correlating purchasing, product and sales.

2.0 Objectives

At the end of this unit, you should be able to:

- state policy issues relating to the extent of vertical integration
- comment on company policies on the production process
- explain policy decisions on how much capacity to operate
- discuss the maintenance and replacement policies.

3.0 Main Content

3.1 Vertical Integration

a. Should we manufacture what sell or should we buy it?

b. If we manufacture, should we just assemble purchased parts or should we make the parts?

c. Should we make or buy raw materials for the parts?

d. Should we produce the supplies needed to make the raw materials?

These are questions of vertical integration. Every firm faces these questions and sound answers to them help a company formulate its policy. Examples of industries where vertical integration is more applied are:

Aircraft industry and publishing, printing and paper making and also the frozen food companies' for example whether farm or not to farm their need supplies. Vertical integration is the growth towards raw material sources and / or distribution network. The desire is to control channels of distribution and sources of supplies and for economies of scale in non-manufacturing processes – research and development purchasing and production planning.

3.1.1 Key Factors in Vertical Integration

From the examples of companies or industries that use Vertical integration one understands that a variety of factors may influence their decisions on when to integrate. Some of those likely factors may include the following:

Possible Benefit resulting from coordination. Where a company manufactures the products or the material it needs. These benefits could be in:-

a. Promptness of delivery.

b. When the parts have to fit together into a complex balance.

c. Adjustment to emergencies may be easier.

d. When the engineering may be more easily coordinated.

e. Unusual quality requirement may be easier to meet.

f. A firm may develop more specialised machinery that is not feasible for an outside supplier to have.

g. It helps a company avoids selling expenses of an outside vendor.

Lower Supply Risks-by acquiring its own sources of making its own raw materials readily available.

Mobility Barriers- company mobility within the supplying industry affects the attractiveness of entering it. If the industry is easy to enter, its products should be readily available (or new suppliers could be encouraged; that the incentive for a consuming company to integrate into that industry would be low.

Conversely, high entry, barriers and a few dominant suppliers in an industry might create conditions where the consuming company would try to get out from under the power of those suppliers by supplying itself. Exit barriers would become important if a company wished to abandon its integration. High exist barriers would tend to delay such a switch, whereas low exit barriers make withdrawal easy.

Flexibility -Vertical integration tends to limit flexibility in product design and shift to completely new design or material because of the heavy investment in plant or raw material sources. Therefore, non-integrating firm can make shift of designs and raw materials easily.

Volume required for Economic Production- Many small companies do not do backward integration because the volume of their requirements for any one part or material is too small to keep and efficient plant busy. Also the requirements may be irregular. Only big companies that require large volume on continuous basis embarked on backward integration.

Financial Status of the Company- Many firms has only enough capital to operate their principal line of business and may not be in a position to acquire new capital for integration. But strong financial firms do.

Capacity of Management to Supervise Additional Activities

This particular point dictates the issue of integration more than any other factors. Problem of supervising or managing large size organisation or business are critical because the capacity cannot stretch to cover every business itself. This factor is critical in decision making. Where this is so difficult, a company will decide not to integrate.

Conclusively, vertical integration decisions in the area discussed above are of substantial significance. Therefore each proposal should be thoroughly examined in terms of the key factors listed, estimated ratio of savings to investment, and unique considerations such as idle plant or lack of technical knowledge before a consciously determined policy statement is mode to move toward vertical integration or to stay away from it. Such a general policy should be based on an appraisal of what is required for success in a company's basic industry, the distinctive competence and resources of the company, desire for diversifying economic risks and similar other factors should be considered.

3.2 Production Processes

Closely related to decisions on what production activities the company will carry out are choices of processes to be used. Broad issues in this area are:

a. Choice of technology

b. Extent of division of labour

c. Degree of automation

d. Size and decentralisation of plants.

3.2.1 Choice of Technology

In the products the manager has no choice regarding the process to be used. For example, a company manufacturing Steel must decide upon the extent to which will use electric furnaces', open-hearth furnaces' or oxygen inverters. Stemming from such basic decisions on technology will affect a whole array of plans for equipment, personnel, method and organisation. The choice of technology does not involve large investment in facilities but it affects personnel, organisation, sales appeals and other facets of the business.

3.2.2 Extent of Division-of Labour

In deciding how much emphasis to give to division of labour, then, managers should weigh their policies regarding standardisation of products, mechanisation, type of labour to be employed, and style of motivation.

3.2.3 Degree of Automation

Automation is widely proposed as a way to increase productivity. The drudgery of factories and slowdowns of operations in offices can be minimised or removed, letting computers do the work. In manufacturing there are degree of automation extending from simple repetition of an operation after a machine is set up to an entire automate factory (that is still a dream in Nigeria.) Among the fascinating possibilities are:

a. The use of robots in place of people.

b. Integrated material handling and inspectors e.g. conveyor's belts etc.

c. Computer – integrated manufacturing

d. CAD (Computer – Assisted Design) simples and speeds up the designing of complex products. Flexibility is featured in all new systems.

Previously, automated production required large volume of identical products to justify the heavy investment in special purpose equipment. In the new systems change is computerised and available almost instantaneously, and this permits short production runs aid low inventory, even though customers want individualised variations in their purchases.

Consequently, any policy to highly mechanize should be accompanied by other plans which will assure the company that it will b able to retain enough of the benefits to pay for the costs of mechanizing.

3.2.4 Size and Decentralisation of Operating Units

Large manufacturing companies have considerable choice in the size and the location of their plants.

Years ago, most assumed that the larger the plant, the more economies would be possible; transportation costs of raw materials or finished products were usually considered the limiting factors of the size of a plant. Present thinking challenges these assumptions. A firm in the clothing industry has a clear cut policy toward separation of production into several operating Units.

Production technology does not require large-scale operations, and the company believes the optimum size plant is one just large enough to support specialised service divisions, there is a question whether expansion should be at the same plant or at a new location. Smaller plants in smaller communities have advantages of closer and friendlier relations among employees, easier identification of the workers with the product produced less bureaucracy, more face to face contacts in place of expensive and impersonal communication systems etc. also modern means of communication and transportation have reduced the disadvantages of having several plants separated from home office.

3.3 How Much Capacity

To arrive as a company productive capacity needs, will require date from sales forecasts of physical volume, policy decisions on what will be purchased instead of made, engineering estimates of machine productivity and production plans on how equipment will be used; all contribute to determine the production capacity needed. In addition and overriding such data are several central management policies regarding capacity desired. These policies deal with provisions for (a) peaks versus normal requirements, (b) backward taper of capacity provision for growth and (c) balance of facilities.

3.3.1 Peak versus Normal Load

A completely stable level of operations is usually impossible. All types of business activity are affected by cyclical fluctuations, and most industries experience seasonal, daily, or even hourly variations in volume of business.

In addition, the demand for a company's product may increase or decrease because of wars, government regulations, inventions, flood, changing fancies of the consumers, and many other influences. Moreover mere random distribution will lead to peaks and valleys.

Management must decide whether it will provide capacity large enough to satisfy all demand s during peak periods, knowing that some of this capacity must remain idle during slack periods or whether it will maintain a smaller capacity and hope that failure to render service during peak requirements will not have unbearable consequences. Other means use for meeting peak capacity usually incorporated is the policy of maximum capacity.

1. Manufactures of standard, durable products may manufacture stock during slack periods
2. Overtime work may be feasible for operations not already run twenty-four hours a day
3. Obsolete or high-cost equipment may be maintained on a standby basis and placed in service just during the peak periods
4. iv. Some of the work may be subcontracted, hoping that such subcontractors are not likely to be busy during such peak periods
5. Off-peak discounts, mail-early campaigns and other measures may be used to induce customers to avoid peak period. These devices involve extra expense and may be more or less satisfactory to customers. Policy guidance is needed to indicate the reliance on these various ways of responding to peak needs.

3.3.2 Backward Taper of Capacity

Vertically integrated companies may deliberately follow a policy of backward taper of capacity. This is an arrangement by which firms perform final operations on all their finished products, at a specified given time or peak periods. Such companies manufacture only parts of their material requirements. And so at peak periods they are quickly assembled together into finished products. Also some of the part during peak periods may be purchase from outside. Such arrangement helps the company production operation to be near productive capacity requirement. The feasibility of this policy depends on the presence of potential suppliers who will supply fluctuating amounts of materials.

3.3.3 Provision for Growth

Logically, a business enterprise does not stand still. In industries enjoying strong growth, time rescues executives who overestimate the capacity they need. But with a slowdown in overall growth rates, excess capacity becomes a continuing burden. Companies should try to avoid the consequences of too much or too title capacity. It is both expensive and inconvenient to customers and employees to have additions to facilities made at frequent intervals in piece meal fashion.

On the other hand, the financial downfall of many firms can be traced to the construction of excessive facilities that usually absorbed a large part of the company's liquid capital and entailed annual charges that further deplete the company's resources.

The basic decision to be made by central management is how much growth to anticipate and the extent to which investment will be made now in anticipation of that growth.

3.3.4 Balancing Capacity

In each phase of an operation materials handling, office processing, warehousing, selling etc, along with their subdivisions, all need to have their own capacity. The problems of capacity are more of physical facilities. Policy statement must be made as to how to deal with peak requirements, what provision to make for growth and how to balance capacity in any kind of enterprise.

3.4 Maintenance and Replacement

Closely related with issues of how much capacity should be provided are issues of maintenance and replacing existing capacity. These have to do with the level of maintenance to operate, preventive maintenance and timing of replacement.

3.4.1 Level of Maintenance

This has to do with the extent to which plant and offices are kept in excellent running conditions. Sloppiness and procrastination are not tolerated. The level of maintenance results partly from the personal preferences of key executives.

Perhaps reflecting a cultural value inherited from their forebears. It may also reflect a calculated decision on the kind of maintenance that will most effectively support the other objectives and policies of the particular company. Since maintenance involves expense on appropriate level needs to be determined for different companies.

3.4.2 Preventive Maintenance

Preventive maintenance can be even more important than keeping the equipment running. e.g. in atomic energy plant, petroleum refineries, air travel etc. The concept is on avoiding accidents because when they occur they are usually very destructive to the whole setting in the enterprise. We are all familiar with this approach in the care of an automobile which involves, regular greasing and oil changes, driving within prescribed limits, prompt inspection of unusual noises or performance and replacing tires when they are worn out. Observing such practices enable one to depend on the automobile's performance. Proper care, regular inspections and scheduled repairs to machineries are designed to avoid unexpected break down.

The same concept can be applied to sales organisation or an accounting office, except that such deal with people, social relationships, paper forms and procedures. The question of degree of carrying out such preventive maintenance will depend on the enterprise and its nature.

3.4.3 Timing of Replacement

Routine replacement of parts of an established facility can be done on a scheduled basis. The replaced item may be rebuilt, but the main aim is to make the change before performance falters. Much more important is replacement to keep pace with modern technology or with economic location for a revised strategy. This encourages companies to depreciate their equipment more rapidly and build replacement. The fundamental issues is how much sacrifice of short-run gain a company's should make to keep itself in top condition to meet competition in the future. When setting replacement policy, central management is reflecting the value it attaches to being a top performer in its industry.

4.0 Conclusion

The planning of production is based upon the facts of the market research and the figures of the sales budget; therefore, the broad policy of the production department is to keep pace with the requirements of the sales organisation.

To meet these requirements, production must be carefully planned and controlled. How this is achieved depends upon the size of the organisation, the processes employed and the end product; in general, how, some or all of the following are taken into consideration in formulating a production policy:

a. Volume of production required- Stated in specific terms and/or as a percentage of optimum production capacity.

b. Design-The design of the production is probably influenced by the results of the market research.

c. Production planning of:

- Material requirements

- Labour requirements
- Machines requirements.

d. Production control- Various control arrangements may be planned as part of the overall production policy, including:

- Control of labour efficiency
- Quality control
- Control of the progress of orders.

5.0 Summary

Major production policy issues centered on deciding the extent to which vertical integration is strategic; selecting the general processes to be used in production and the of setting total capacity and facility balance were discussed in this unit. Management must decide whether it will provide capacity large enough to satisfy all demands during peak periods, knowing that some of this capacity must remain idle during slack periods or whether it will maintain a smaller capacity and hope that failure to render service during peak requirements will not have unbearable consequences.

6.0 Self-Assessment Exercise

The broad policy of the production department is to keep pace with the requirements of the sales organisation. How can this be met.

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Unit 4 Procurement Policy

1.0 Introduction

As indicated in the last unit, the policy of top management is communicated to the lower levels of management only in general terms. At that point it branches off into the separate sectional policies of the respective managers, by whatever name they are called. Although these "managers" must work together as a team to implement the general policy, each of them is individually responsible for its own sectional policy. One of the most important sectional policies a large manufacturing company must project is about the procurement and supply. This is the focus of this unit.

2.0 Objectives

At the end of this unit, you should be able to:

- discuss the intricacies of policies of make – or – buy decisions
- state the guides to make – or – buy decisions
- explain the issues involved in vendor selection
- present a tabular summary of the factors that informs vendor's selection.

3.0 Main Content

3.1 Make or Buy Supplies and Services

Every company uses variety of supplies and services-heat, power, packaging, transportation in and out, telephone, electronic computing, and many other items. Time and again the question arises of whether to make or buy these supplies and services. The following examples suggest the nature of the problem.

Production of Containers Printed Form

All firms must decide whether to purchase or manufacture her supplies such as plastic containers, cartons and seals. Large insurance companies, for instance, often have a shop in which they print their own forms, circulars and notices, and do other job printing.

While this practice is convenient, few firms have enough actual printing (not just photocopies) of a similar type to justify the most economical machine methods. Consequently policy usually is to have such printing done by an outside firm which serves many customers.

A similar situation exists in connection with packing boxes, for example, the Evans Pharmaceutical Company which has its own box shop, needed boxes in a considerable range of shapes and sizes for the packing of its various products. Because of the 'variety, several different machines were needed, however, most of these machines were used only part of the time. While the boxes made in the local shop were satisfactory, an independent check showed that it would be less expensive for the company to purchase boxes from a manufacturer specialising in this type of work. This also gave the company more flexibility to shift to plastic containers.

On the other hand, a leading manufacturer of prepared breakfast foods concluded, after an exhaustive study of the relative costs of manufacturing and of buying packages and cartons that a considerable saving would result from its own manufacture of these products.

In this instance, large quantities of identical boxes and cartons were required, and the cereal company was able to install machinery as efficient as the independent box companies. Furthermore, under this arrangement the company was able to exercise direct control over all phases of production and to coordinate under the same roof the manufacture of the packing boxes with the packing of the final product. This same company however, decided that its job printing could be done more economically by an outside concern.

Company Power Plants

Large companies must decide whether they produce their own power and light or buy all their electric current from a public utility. The policy sometimes followed in this case is to manufacture within or to purchase from the public utility only for the purpose of meeting peak requirements. Thus, the company plant can be operated continuously and the burden of fluctuating demand can be shifted to the public utility.

The feasibility of such a plan depends, of course, upon the rates charged by the public utility. If the peak demand for a particular company occurs at the same time that other utility customers have peak demands, the rates charge are likely to be high. Emergency power supply for hospitals, alarm systems, dairy farms, and the like is quite a different issue. For a safety, in-house generators or batteries are needed.

3.2 Guides to Make-or-But Policy

The following line of analysis provides an answer to most make-or-buy questions relating to supplies and services.

1. Does a dependable outside source exist? If the answer is "no", then we presume that our own production is best unless unforeseen obstacles arise. For instance, a cement plant in Sokoto has its own foundry and machine shop because no reliable source of repair parts is within reach. Similarly, most large industrial plants in Aba have their own power plants because public power is unreliable.

2. When a dependable outside source does exist, we will use it unless a strong case can be made for not doing so. The reason for this preference include simplifying the total managerial burden, focusing executive attention where major sources, and –in competitive markets-gaining some of the economies that supplies serving several customers will obtain.

3. Possible reasons for making exceptions to the preference for buying, just stated in (2), are:

a. Coordination with outside sources would be very cumbers example, although office buildings frequently contract for janitor service and window washing, industrial plants rarely do so because cleaning up is intimately related to plant operations.

b. A large volume of a uniform item would result in unusually low costs.

c. The supply source is unwilling to provide special services (for example, speedy delivery or unusual sizes) we desire.

This approach at least puts the burden of proof on the executive who suggests deviating from the main activities on which the firm is staking its success.

3.3 Selection of Vendors

Regardless of how a company resolves its problems of vertical integration and of make-or-buy supplies, some sorts of goods must be purchased. The manufacturer must buy raw materials and factory supplies, the retailer must buy finished goods, and even the professional firm must buy office supplies. In most businesses, a number of vendors, local or perhaps foreign, are available to fill these needs. This raises the question of whether purchasing from several vendors is wiser than concentrating the business on only one or two. Even after this policy is settled, the issue of vendor that will be the most satisfactory source has to be resolved.

3.3.1 Number of Vendors

The number of suppliers of at least the essential products purchase by a firm should receive careful attention. Entire operations of the firms can be jeopardised if this issue is not wisely handled.

Allocating, Buying to Multiple Vendor Sources

A school supply jobber, for instance, followed the practice for a number of years of buying from as many different manufacturers as possible so that the firm name might be widely known. The company later became involved in financial difficulties and recreated its policy of using a large number of vendors. The purchase it made from any one manufacturer were not important enough to that manufacturer to justify granting special credit terms, and each vendor sought to collect bills promptly. Had this firm concentrated its purchases to a greater extent, it might have induced its vendors to be more lenient in making collections during the period of financial stress.

Advantages and Dangers of Concentration

A few companies that buy large quantities of merchandise concentrate their purchases to such an extent that they buy the entire output off a single supplier. By doing so, they are able to secure favourable prices because the manufacturer is relieved of all selling cost and is able to concentrate its product operation on just those commodities desired by its one customer. A danger in this practice is that the manufacturer may fail to make delivery because of (i) labor troubles, (ii) lack of capital, (iii) fire or some other catastrophe, thus leaving the company deprived of its supply of product at a time when they are sorely needed.

Also, relative power is involved. If there is a single supplier of a vital part or material, that supplier may have a lot of power. A threat-implied or explicit-to shut off the flow of a needed resource can force the buyer to pay a high price or to accept irregular delivery. The potency of such a threat depends, of course, on the availability of alternative source of supply.

A large mail order house that was buying the entire output of a refrigerator plant guarded against these dangers to some degree by having at the plant its own representative who watched accounting records and was familiar with plant operations. Such a representative could warn the mail-order house of any impending difficulties. Another large firm followed the policy of buying no more than 25 percent of its requirements any one product from the same manufacturer. If for any reason something happened to one of these source of supply, the company would be able to continue to get at least 75 percent of its requirements from its other vendors. When buying abroad, use of several sources gives protection against political interruptions – as petroleum companies using Middle East crude oil well know.

Many firms follow a policy that seeks to gain the advantages of both concentration of purchases and multiple vendors. They find that buying most of their needs of a particular material from one source is desirable, the quality, price, delivery service, or some other factor makes concentration clearly the best arrangement. So, they give 70 to 80 percent of their business to one vendor. The remaining part of the business is divided among several other suppliers. In this manner, business relations are established, specification problems are met and resolved, and the way is prepared for much large purchases at a later date. Placing these small orders with several vendors is probably more expensive than buying all requirements from the chief source, but it serves two important purposes;

1 if a strike, fire, or other catastrophe hits the main supplier, the firm can shift to other supplier much more quickly than it could if no relationship had been established; and

2 The main supplier is "kept on toes" because the buyer is in close touch with the market and in a position to shift to other supplier if the price, quality, or service from the main source does not continue to be the best.

Buying distress merchandise, some retail stores appeal to their customers primarily on the basis of price, and in order to make a profit they continually seek to buy merchandise at "distress" prices.

These stores usually offer to pay cash for merchandise, and they are not particularly concerned about being able to secure additional products from the same company. Such stores will deal with any vendors who have merchandise to offer for sale at a reasonable price, and they are continually "shopping around" for more favorable terms. Although such a policy appears to be good for companies operating on a purely price or cut-rate basis, most concerns have learned by experience that it is preferable to cooperate with vendors. A cooperative relationship will not be disrupted by either party because of apparent temporary advantages that may be obtained from time to time under special conditions.

3.3.2 Factors Determining Number of Vendors

It is often necessary to balance the advantages of better service and quantity discounts that can be secured by concentrating business with a few vendors against the disadvantages of possible failure of supply and the passing up of occasional bargain merchandise. The problem often resolves itself into the following questions.

1. Can a limited number of vendors supply the variety of products required?
2. How much special service and price concession will result from concentration?
3. How important is such service to the purchaser?
4. Is the company too dependent upon any one company for materials?

3.3.3 Type of Vendors

The type of vendors selected by a company will depend on the company's requirements in regard to quality, service, reciprocity, and price.

1. Importance attached to quality: Selection of vendors by a company will be influenced, in part by the quality of the product that it wishes. Thus a publishing house, desiring all its books to be made of a high-quality material, buys only from mill as that make paper of dependable quality. Although paper is purchased according to detailed specifications, every paper mill has some difficulty controlling quality. The publishing house therefore prefers to pay somewhat higher prices to those mills that have a reputation for exercising care in maintaining the quality of their products.

Even a product that is highly standardised and that has a recognised market price may be purchased from one vendor rather than another in order to secure certain intangible qualities. Operators of textile mills, for instance, point out that considerable variation occurs in the way raw cotton of identical staple and grade will work up in cloth. Consequently, when a textile mill discovers that cotton coming from one region through a given broker is more easily handled on its equipment, that mill will try to concentrate its future purchases on cotton coming from that particular section.

Service of Vendors: Vendors may be selected because of the service they render their customers. For example, companies manufacturing computers, duplicators, and other types of office equipment often give their customers a great deal of aid in designing office forms and in establishing new systems. Most of these companies also maintain an extensive repair service; if a machine should break down, it can be quickly repaired without serious interruption in the work of the office using the equipment.

The importance of such service became striking in Nigeria when that market was flooded with relatively inexpensive office equipment of China manufacture. The machines had entered Nigeria under a specified quantity of machinery from China. Inadequate provision had been made for servicing the China machines. However, consequently, when one of these machines broke down, it was both expensive and time-consuming to get it back into working order. As a result, many of the office managers were turning to more expensive American machines because of the repair maintained by the American manufacturers.

Under some conditions promptness of delivery is a controlling factor in the selection of vendors. This has been one of the primary reasons why small steel companies have been able to secure in their local territories business that otherwise might have gone to the big steel companies.

With standardised products and uniform prices prevailing in the industry, such special services as delivery often become controlling influence. The large companies have recently given more recognition to this factor and have spent substantial funds in an effort to expedite the handling of customers' orders.

Reciprocity: Under special circumstance vendors are selected on the basis of reciprocity. Thus, railroads are careful to place order with concerns that are in a position to route a large quantity of freight over their lines. Sometimes the reciprocity may be a three cornered deal. For instance, an Enugu steamship company decided to place a large order for motors with a particular manufacturer as a favour to a pig-iron producer. The pig-iron producer shipped large quantities of ore and could therefore demand favors from the steamship company in exchange for a contract to transport ore. To complete the circle, the pig-iron product used it s controls over the order for motors in selling pig-iron to the motor manufacturer.

Hence, each of the three concerns selected vendors with an eye to the indirect effect such selection would have on sales. Formal reciprocity agreements have been challenged legally as a restraint of trade, but this aspect is very cloudy. Much more common is the objection of "professional" purchasing agents. In fact, a policy on reciprocity is often necessary to keep peace between the purchasing department and the sales department.

Role of price: Thus far, no mention has been made of price in connection with the type of vendors. Prices for many products are uniform, and for other products the differences are not of sufficient important to offset such factors as quality and special service. It should be clear, however, that price is an ever-present consideration, and if for some reason one vendor charges higher prices than another, the former is automatically eliminated unless there is some special reason for dealing with that particular vendor. As already noted, the significance of differences in prices depends partly upon the emphasis that the company buying the material gives to price in reselling the material and also upon the importance of that particular product to the total cost of the company.

Gifts and Friendship: Especially when large purchases are to be made, gifts and lavish entertainment may be offered to the person who selects the vendor. In this gross form this is clearly bribery. But the line is hard to draw; for instance, is a free lunch unacceptable do strict as government or rules regarding favors, most companies do have a clear-cut policy forbidding the acceptance of any significant gifts from vendors. More subtle is the question of friendship. Business relationships naturally lead to numerous contacts and mutual dependence. Friendship often grows out of such contacts. And cooperation between friends typically flows in both directions.

The principle that we assume should guide business relations between friends is clear enough; cooperate to the hilt as long as the interest of the two companies are compatible (and such action is legal), but when interest conflict always give one's own company uncompromising priority. This norm is so widely understood it is rarely stated as a policy.

3.4 Summary Regarding Selection of Vendors

In selecting vendors a company is responding to the sales appeal of the numerous companies desiring to sell merchandise of the type used by the company. The point of views, however, is essentially different because the purchasing company is concerned only with its own specific problems and has no interest in the sales activities of the vendor unless these activities are of some value to it.

There are also a number of questions, such as the number of vendors that do not have an exact counterpart for the seller. The more important factors that should be considered in making vendor selections are indicated in Table 4.1.

Table 4.1: Factors Influence Vendor Selections

Capacity and Willingness of Vendor to Meet Company Needs	**General Characteristics of Desirable Vendors**	**Factors Limiting the the Choice**
Quality of Product:	Size of vendor Reciprocity Specifications Interest in our	
Dependability	business Time and expense Financial stability of locating and dealing with new vendor	
Services offered:	Geographic location:	
Delivery	Support of "local"	Habit and conservatism;
Technical aid	industry	Potential "headaches
Repair	Dispersion of risks	in new relationship
Credit terms		
Guarantees	Manufacturer us, jobber	Friendship and loyalty
Adjustments		
Price	Maintenance of	Willingness of using
Competitive level	alternative sources	departments of try
Inclination to squeeze	divides equally	new vendors
Protection on changes	other minor	

Company policy determines which of these factors should be given primary consideration and which should be disregarded.

4.0 Conclusion

It is important to conclude this unit with a reminder that the number of suppliers of at least the essential products purchase by a firm should receive careful attention. Entire operations of the firms can be jeopardised if this issue is not wisely handled.

It is often necessary to balance the advantages of better service and quantity discounts that can be secured by concentrating business with a few vendors against the disadvantages of possible failure of supply and the passing up of occasional bargain merchandise.

5.0 Summary

Regardless of how a company resolves its problems of vertical integration and of make-or-buy supplies, some sorts of goods must be purchased. The manufacturer must buy raw materials and factory supplies, the retailer must buy finished goods, and even the professional firm must buy office supplies. In most businesses, a number of vendors, local or perhaps foreign, are available to fill these needs. This raises the question of whether purchasing from several vendors is wiser than concentrating the business on only one or two. Even after this policy is settled, the issue of vendor that will be the most satisfactory source has to be resolved.

6.0 Self-Assessment Exercise

What are the policy bases for your company vendor's selection? Explain them in detail

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Unit 5 Financial Policy

1.0 Introduction

Capital is an essential resource for even enterprise. Equipment must be obtained, material purchased, employees paid, sales and administration expenses met before goods are made available for sale. In formulating policy regarding uses and sources of capital, cash flows require primary attention that is; you pay greater attention to cash flows as all other organic function of a business. Capital already invested in fixed assets or debts already incurred become active when they affect the inflow or the out flow of cash.

In a sense, financial policy concerning the use of capital does not stipulate the specific uses of capital. Other management decisions such as product to be sold, sale appeals to be stressed "decisions to make rather than (to) buy" heavy use of automation etc. dictates the specific uses of capital. This unit addresses the important organic function of an organisation from the policy perspectives.

2.0 Objectives

At the end of this unit, you should be able to:

- explain the dimensions of a company policy on regulation investment in fix asset
- discuss a company policy concerns relating to profit
- comment adequately on the policies affecting distribution of earnings (dividend)
- describe the policies governing the deployment or otherwise of the various financial instrument
- explain the policy areas of a company financial structure.

3.0 Main Content

3.1 Policy on Regulation Investment in Fix Asset

3.1.1 General Restrictions

Several proposals in every organisation are often forwarded to the central management which carries some budget. Hence there are certain restriction often set by organisations for example the need for new equipment must be accompanied by a convincing proof of need for such equipment. Hence decisions are not just taken without seen the benefit of such a decision to the organisation. General restriction in capital will therefore normally tell the management not to send proposal that falls below the competency or domain of the organisation. Hence proposal must show consistency with long range plans otherwise it will be rejected.

3.1.2 Consistency with Long Range Plans

Proposal must conform to the long range plan or already defined corporate strategy, and when it does not addressed main domain of the organisations business, central management will therefore reject any proposal that is not consistent with the level of organisational operation.

3.1.3 Hurdle Rate of Return

This is a different kind of investment fund which is a minimum rate of return that must be anticipated if capital is to be assigned to a proposal. For example, the policy management is that any new investment in fixed asset must earn at least 15% annually on the initial investment after provision for depreciation and taxes. Then a proposal to buy an accounting machine lusting N100,000 that was expected to result in an average net saving of N12,000 per year-during it life world be rejected because the 12% return falls below the acceptable minimum – that is the hurdle rate.

3.1.4 Risk classification

Many investments are so risky that they should have an expected return higher than the basic hurdle rate. Uncertainly surrounds every investment for example workers many like the change or they may sabotage it. Materials and energy inputs many cost more than expected or may even be unavailable, customers tastes may shift and competitors many react vigorously. Since one investment in subject to many more uncertainties than another, we cannot compare them out making an adjustment for differences in risk.

3.1.5 Capital Budgeting

Frequently a company has more possible investments in fixed assets than it can finance. The issue then becomes which project to finance and which to reject. At that level of decision therefore capital budgeting is very important.

Given all the data available to assist in decision making, it is easy to decide upon which project to reject and which one to implement. The predicted investment and result of each proposal should be expensed in naira as much as possible. The figures that are critical are:

a. Additional outlays the company will make if the project is undertaken and

b. Additional receipts that will results from the project of capital budgeting.

The question that should naturally follow after every decision for expenditure in how much will to make or get and how much loss will I incur? Also how much will be saved from buying one equipment instead of the other. Receipts can therefore be in term of actual receipt coming into an organisation and how much receipt can be reduced or what can be saved. Hence central management must always ensure that the asset either increase the company asset or reduce the company expenses. Such questions will answer which project to accept or reject and which investment to go into or decline.

3.1.6 Investment Mix

This is directly related to market clarification and it operates this way:-

Every firm makes some high risk investment and some low risk investment. Just as the "marketing mix" used by a company should be adapted to its strategy, so also should the "investment mix. Companies that make only high risk investment will be too unstable while all minimum risk investment forced liquidation. Therefore when decision on investments is at stake, you have to mix the high with the how risk investment so that each complement the other in time of crisis in one investment level. It is like not putting one's egg in one basket. You diversify so that the unforeseen is seen afar off.

3.1.7 Leasing versus Purchase of Fixed Asset

Once analysis of investment proposals are made it many reveal the viability of one project to the other. A company may therefore either borrow money to buy or get another company to lease (or rent) from. Leasing can take two forms; either the owner company buys the item and lease to you or get an insurance company or any other investment house to undertake the project. Or get other people to whom you sell your built house and in turn lease the house.

So at policy level, learning is meant to reduce the risk of tying the capital so that additional capital can be left in the company. In other words, at policy level, we are concerned with leasing as a way of reducing the need for tying up capital in fixed assets and this is the way it works: An investor (insurance company) with funds for long term investment buys a building we want to use and at the same time least it to us for a long period.

The rental payments are high enough to cover real estate taxes, depreciation and repairs, as well as interest on the capital tied up. (Note that these are all experiences we would have to pay if we owned the building). If the asset to be leased has to be constructed for our own peculiar requirements we may actually build and equip the structure and sell and lease back. Also, we may have option to buy asset when the lease expires at a depreciate value.

A few companies have a policy to lease rather than buy certain types of assets. Most firms resort to leasing only occasionally for some large asset. The general policy of a company regarding its investment in fixed assets and capital budgeting, comparisons of an alternative uses of company resources should normally apply to property leased for a long term as well as property that is purchased.

3.1.8 Policy on Inventory Turnover

A sound method to limit inventory is in terms of turnover ratios. The turnover standard creates pressure to dispose of slow-moving, obsolete stock accumulation if such stock is likely to lead to future uses. (A classical is the regular discount sales at some furniture companies). Since inventory turnover is frequently used by outside credit analysis, a company standing can be improved by fast inventory turnover into industry averages.

3.1.9 Investment in Account Receivable

The company credit policy should aid the execution of structure. This means that the liberality in granting credit to customers and in making connection should be consistent with the stress placed in credit as a sales appeal. Budgetary limit may be set for the total capital allocation to account receivable. Turnover ratios can be set to check the soundness of account and to avoid further long from an accumulation from uncollectible accounts.

The basic task of central management in the area of account receivable is to set policy regarding purpose, allocation of capital among competing uses and maintenance on the quality of the asset.

3.1.10 Policy Restraints on Current Assets

Operating Needs for Inventory

The size and composition of inventory should be determined primarily by operating needs. The following factors should be considered**:** minimum inventory necessary for uninterrupted operations, EOQ, Advance purchases to get seasonal discounts, and anticipation of price changes and shortages of supply.

Budgetary Limits on Inventory

Inventory absorbs capital. The cash spent for finished goods, work in process, and raw materials is not available for other uses as long as these stocks remain on hand. Consequently, financial policy dealing with the allocation of capital to competing uses frequently places an overall limit on the size of inventories.

3.2 Profits

Allocating capital among fixed and current asset is part of broader task of guiding the flow of capital in, around and out of the company. Management has significant discretion on how profit is calculated. Income taxes, reputation in the financial community and hence ability to raise new capital are affected by these calculations.

3.2.1 Account Reserves

The extent to the account reserves are set up may affect company profit significantly. The issue of what expenses to anticipate in account reserves and what the decline in assets value to show in such reserves must be addressed. Expenses that involve an immediate outlay of cash such as a bill from the vendor of raw materials are easily recognised. On the other hand, expenses that require no immediate outlay of cash but that must be met eventually are subject to greater error or manipulation.

Depreciation of equipment or and building, provision for uncollectible account and unanticipated expenses such as unaccepted taxes or contingent loses are examples of these latter type. (Often the amount of the expenses is not known accurately and opinion may differ as to how much should be charged against the operation of a particular year). The customary way of handling such items is to make a reasonable estimate of the amount to be charged against operation each year, and then to include this figure along with other expenses as a deduction from gross income in the calculation of net profit.

At the same time, a so called "reserve" is setup on the account books in anticipation of the time when the cash payment (or the discarding of a assets) will take place (it should be remembered that this reserve is not a special cash fund put aside to meet an anticipated cash payment) such an account performs an important function in preventing the overstatement of profit.

3.2.2 Capitalisation of Disbursement

A similar issue arises in the treatment of product development expenses and improvement of fixed asset. Here the cash has been paid out but the question is whether to treat the disbursement in the current year and thereby reduce profit or to capitalise it (for instance when a wooden floor in the plant in replaced a concrete one, should the cost be treated in a repair, expense or should at least part of the outlay be shown as an asset?). Disbursement for intangibles for training are regularly treated as expenses but what of cost of elaborate demonstration model which were built for AU/ECA trade fair will be used for several additional years?

3.2.3 Inventory Valuation

Still another fuzzy area in the computation of profits is valuing inventory. Judgment has to be exercised in deciding what is obsolete, damaged beyond its point of usefulness, or missing an essential bearing. Value depend on future demand, as well as in physical condition of the inventory but future need in the company for repair point or demand, by customers often is uncertain is certain. The higher the value attached to inventory carried as an asset higher the current profit. Inflation adds further questions on inventory valuation. If inflation causes a specific item to rise in value while it is held in inventory, the company can sell that item at attractive nominal prices.

But the cost of placing the item has also risen. **(**So much or all of the normal profit used up just getting the physical inventory back to the starting size. Real profits have been over stated in such a situation. One way reduce such a misleading statement of profit is to compute cost on a LIFO **(**last in first out**)** basis. Here the price of the most recently purchased item is used to compute profit. Thus, the use of LIFO helps to cut down over stating of profit during inflation**)**.

3.2.4 Policy Issues in Profit Determination

Limitation surrounds the size of reserves, the capitalisation of costs and valuation of inventories. Federal tax regulations of what may be treated as an expense on income tax returns (and hence not taxed) are comprehensive. Securities and Exchange Commission stipulations stress full disclosure in annual financial report. Central management does not deal with current specific entry involved in profit computation. Instead, it should set general policy indicating the degree of conservation to be followed throughout the company. (When room for judgment is present, should it be resolved on low value of assets, large reserves, and to the extent that these entries are acceptable to the internal revenue service).

Like so many other policy problems, calculation of profit is interrelated with several aspect of central management. Protection of capital, cost for conservative estimation of profit, but income taxes, executive incentives and ease of using new capital also should be considered. In addition to these explicit factors, the policy should reflect the kind of company envisaged in its structure. A risk-taking, fast growth, volatile financial enterprise needs a public image quite different from a dependable, steady growth stable enterprise.

3.3 Distribution of Earnings (Dividend)

Net profits of a company after income taxes belong to the share holders. These does not mean that the share holders will receive a cash dividend equal to their share of profit the board of directors may decide that part or all of the profit should be kept in the company. However, policy regarding the disposition of profits varies widely.

3.3.1 Ploughing Back Profit

A common practice in business is to use profit as a source of additional capital. The process of ploughing earnings back into business rather than distributing them in the form of dividend has proved to be such a desirable practice in the past that some authorities advocated a standard policy of distributing no more than half of the profit to the owners inform of dividends. Such policies certainly contribute to the financial strength of a company, but it may lead to the accumulation of unnecessary capital if the company is not expanding the scope of its operations.

3.3.2 Inflation and Dividends

Traditional attitudes frowns at the payment of divided in excess of current earnings. The tie between current earnings and dividends is especially sensitive during inflation. Inflation leads to an overstatement of earnings because the cost of materials taken out of inventory usually understated relative to replacement cost. And the cost of fixed asset (depreciation) is likewise understated.

These overstated earnings are insidious for three reasons:

a. They give a false guide to the real profitability of the business.

b. They are subject to income tax and this constitutes a drain of capital out of the company.

c. And they mislead management in pricing and other competitive moves.

The combine result is likely to be a shortage cash simply to maintain productive capability of the business. Consequently, during inflation it is particularly important to consider whether current earnings are adequate to warrant paying dividends or whether an even higher than usual percentage of stated earnings should be plough back into the business.

3.3.3 Stable Dividends

Another dividend policy is the payment to shareholders of a regular amount of dividend each year. Ordinary share and preferred stock on which dividends are paid regularly tend to have a better mark and are more likely to be regarded by purchasers as an investment rather than a speculation. To maintain a stable dividend rate, it often necessary to retain part of the profit earned in prosperous years, irrespective of the present needs of the company for additional capital, so that dividend in less prosperous can be assured.

Inflation also bears are dividend policy for example, if a company depreciate its fixed assets on historical cost (not replacement cost); it is failing to recoup its real costs. Such low costs lead to higher stated profit and higher dividend (then when the company must replace worn out asset, there is insufficient capital to pay the inflated prices of new equipment. This line of reasoning suggests that dividend policy should always be tied to real profit.

3.3.4 Need for Adequate Retain Earnings

It illegal to pay dividends that wipe out the retain earnings account and create on capital deficit. A relatively large retains earning account is desired because any operating losses on dividends in excess of profit may be charged against this account without impinging the original invested.

3.4 Financial Instrument

The cultivation of adequate resources of capital is of prime concern to central management. The principal sources of capital available to most company are the owners long and short – term creditors.

3.4.1 Owners

Some cash for investment is generated within a company from a book keeping reduction in the value of assets, called depreciation which is an "expense" but involves no disbursement of cash. A second internal source of cash is retained earnings.

3.4.1 (A) Common Stock

A share of common stock is simply a small percentage of ownership of a company. So, when we raise capital by selling stock, we are trading a bit of ownership for cash (If 100 shares are outstanding, each share reps 0.01 of the owners claim on company and on asset if the company is liquidated.

When additional shares are sold, profits have to be divided into more pieces, giving the original share holder a smaller portion of what they hope will be a bigger pie. The new shareholders pay in capital for the right to a piece of this bigger pie usually expressed as earning per share.

3.4.1 (B) Preferred Stock

If a company issue, N10 preferred stock, a N10 dividend will be paid on each share before any dividend can be paid on common. In addition, addition preferred stock dividends are usually cumulative. Thus, if no dividends are paid on the preferred stock, just mentioned for two years, N20 for back and N10 for current dividend would have to be paid on each share of preferred stock in the third year before any dividend could be declared on common stock.

3.4.1 (C) Frequent use of Stock to Raise Capital

The sale of additional stock is often used to raise money for expansion. To attract particular types of investors, a package of preferred and common stocks may be sold as a unit **(**sometime warrants entitling the bearer to purchase common stock at a stated price included with a share of preferred stock or current stock, thus giving the holder of the warrant an opportunity to benefit from the price rise).

3.4.2 Long Term Creditors

In addition to investment by owners, capital may be secured by borrowing it from long term or short term creditors.

3.4.2 (A) Trading on Equity

The advantages and disadvantages of obtaining capital from long term creditor are illustrated in the situation facing Bolodeoku limited. This company with asset of about N4, 000,000 wished to finance an expansion programming that would cost N10, 000,000. The new expansion might have been financed by sale of additional stock. The present share holders however did not wish to use this source of capital because high income taxes make earnings of net profit more difficult than any money to pay bond interest and all profits would have to be shared with the new share holders). Interest on borrowed capital is an expense deducted from income before income taxes is computed.

Profits available for stock holders are net income after income tax has been paid. Consequently a corporation in the 48% income tax bracket has to earn almost N2 for each naira available to stockholders (if capital is borrowed, less earnings are needed to pay for the use of capital because the tax collection has not taken a toll.) The effect of these factors on the Bolodeoku limited can be seen by comparing this position of operating profit under bond on stock financing. The Bolodeoku already had outstanding N140, 000 of 9¾% bond, N90, 000 if 10% pr stock and N90, 000 of 10% preferred stock and N90, 000 at common stock to capital. It was estimated that an annual operating profit of N55, 000 would be earned when the expansion was completed. The effect of borrowing the necN90, 000 at 9¾% or selling stock at par are shown in table 13.1

Borrowing N90, 000 at 9¾% **Selling N90, 000**

Estimated annual operating profit N55, 000 N55, 000

Less bond interest 22,425 22,425 13,650

Net profit before income tax 32,575 32,575 41,350

Income tax @ 48% 15,636 15,639 19,848

Net profit------------------------ 16,939 16,939 21,502

Less preferred stock dividends 9,000 9,000

Available for common stock holders……… 7,939 12,502

Rate of Return on par value of

common stocks outstanding------------------- **8.8%** **6.9%**

The present stock holder would profit by borrowing because a large rate of return will be earned on capital than would be required for interest. If for some reasons however the operating profit should fall to N47, 000 or N39, 000 the earnings on common stock would have been altered as illustrated in table 13.2

Rate of return on common stock outstanding

Annual operating **Borrowing N90, 000** **selling N90, 000**

Profit (N) **at 9 ¾ %** **of common stock**

55,0008.8% 6.9%

47,000 4.2% 4.6%

39,000 -0.4% 2.3%

Thus by borrowing the common stock holders increase their possibility for profit but also incur a greater risk of loss. Such use of bonds for raising capital is referred to as trading on the equity.

3.4.2 (B) Instrument for Long Term Borrowing

Trading in equity may be accomplished through the use of any of the following instruments.

i. Mortgages**-** To attract long term capital, a mortgage on real estate or other assets may be given as security. If the interest and principal of the loan are not paid on schedule, the lender may force the sale of the mortgaged property and use the money to repay the debt. If the proceeds do not cover the entire debt, the borrower is still liable for the remaining balance.

ii. Bonds- To borrow large amount, the total can be divided into a series of bonds that can be resold to as many lenders as necessary to secure the sum desired. The bonds may be secured by mortgage or other pledged asset, or they may be debentures that rely only on the financial strength of the borrower. (Typically, a borrower who issues bond must continuous to meet stipulated requirements such as maintain minimum working capital, having no prior debt, paying conservative dividend.

Also must bonds either call serial payment year by year or have a sinking fund in which money to repay the debt is a communicated. Bonds usually are callable by the borrower if the borrower willing to pay a premium. This provision are stated to the bond in denture and administered by a trustee.

iii. Long term notes-Large sum can be borrowed from a single financial institution like a life insurance company (or a trust company). Here dividing the loan into bonds is necessary. Instead 10---, 15---, or 20--- year promissory notes are used. However there is an agreement similar to a bond indenture stipulating various protective measures and the payment schedule **(**Such private placement avoids underwriting costs. Their use depends largely on the total to be borrowed and the comparative interest expenses. Then numerous variations can be used to lenders**)**. In addition to interest rate, maturity and protective features, some loans are convertible into common stock.

3.4.3 Short Term Creditors

Short term creditors are better adopted to supply funds for seasonal requirement or other temporary needs.

3.4.3 (A) Commercial Bank

The most desirable way to borrowing from a commercial bank is to establish a credit line

3.4.3 (B) Merchandise Creditors

Companies normally purchase product and services 'on account' that is, they make payment 30-60 days after products are shipped with a continuing flow purchases, and some bills will always be unpaid. Buying on trade credit is but a counterpart of the use of capital to finance account receivable from customers.

3.4.3 (C) Other Short Term Credit

Postponing payment of taxes, installment on machinery and even advance payment by customers can be resorted to in periods of stringency

3.5 Financial Structure

The various sources of capital used by a company make up its financial structure. In establishing policy for obtaining capital, the overall capital structure must be considered because the relative importance of one source will affect the desirability of others. The size of the company, the nature of its assets, the amount and the stability of its earnings the condition existing in the financial market at the time the capital was raised; all have an influence in the sources of capital used by the company. At any given time, the right hand side of the balanced sheet of a company will reflect its financial structure.

3.5.1 Selecting Capital Sources

3.5.1 (A) Inventory Patterns

Typical financial structures of other companies in its industry will give management a lead on what financial community will accept as satisfactory. More often than not however, while variations in assets, in earrings, and in existing capital structure, in addition to differences in management makes the reliance upon typical industry pattern both unsatisfactory and even dangerous. The policy adopted should suit a particular company and the conditions existing at the time plans for the financial structure are made.

3.5.1 (B) Use of Capital

Funds to finance seasonal peak or other temporary need can best be obtained from short term creditors such as commercial banks. On the other hand, capital for fixed assets or for circulating capital that will be permanently retained in the business calls for a different solution. As an effect guarantee that a loan will be repaid, a company many pledge a security of one or more of the following assets; inventories that can be readily sold in the market; machinery that is standard in design and that can be easily moved from one plant to another; building located and designed so that they are suitable for use by other companies or in marketable securities. If the funds are to be used for purposes that cannot be made to yield cash readily, the raising of capital from owners is indicated.

3.5.1 (C) Cost of capital

To ascertain the cost of capital, consideration should be given to the original cost of obtaining it and able to compensation to be paid for its use.

Underwriting and Registration

Securing capital by issuing bonds or selling stock to the public often involves a considerable expenditure. Frequently this security is sold through an investment banker, and in most instances substantial commission must be paid to the investment bankers for their services. Also complicated legal requirement invest be complied with before such securities can be sold.

Federal legislation requires the registration of all the widely distributed securities with the security and exchange commission and the expenses involve in preparing the detailed statements required for registration is quite large. Private placement of bonds and long term notes also entails a legal account fees and perhaps a fee to consultant who helps arrange the loan. But the total expense is less than 50% of a public sale).

Use of Right

Some companies are able to sell securities directly to present stockholders. The characters of annually companies require that when additional stock in sold, it must be offered to the present shareholders and the present shareholders may exercise their right to the new issue. When this procedure is possible the cost of securing additional may be reduced substantially.

Adjusting Sources to Prevailing Rate

The interest that must be paid for the use of capital not only varies according to the use to be made of the capital, but also it's often affected materially by the state of the finance market. Interest rate reflects the anticipated level of inflation during the period of a loan and also the efforts of the CBN to control inflation.

Return Paid on New Stock

When common stock in sold to obtain additional capital, the new stock holder will spare in any dividends paid and will reduce the amount dividends available to former stockholders. This sharing of dividends is a cost of capital as for on the former shareholders are concerned, many companies prefer to secure capital from the sale of stock even through it is anticipated that earnings necessary to this stock will exceed the interest that would have to be paid on the bonds. Their willingness in this lager cost lies in the fact that dividend do not have to be paid, when there is not a sufficient amount of earnings or cash to justify their declaration.

3.5.2 Rights Granted with New Securities

The final factor to be considered in selecting the source from which capital should be secured is the authority exercised by different contributors of capital.

3.5.2 (A) Rights Granted to Creditors

If capital is obtained from short term creditors they usually have no control over affairs of the company. However if their obligations are not paid at maturity, they have the right to bring legal actions against the company to enforce their claims. Likewise long term creditors have no voice in the current operation of the company although a bond indenture may impose certain restrictions on the management. The loan agreement may also restrict the freedom of the company to pay dividends.

3.5.2 (B) Right Granted to Stock Holders

If capital is secured by the sale of stock, the new shareholders have certain rights with reference to the company. The new shareholders have full voting rights and they become participant in future management and control of the company.

Preferred shareholders normally do not exercise control over company operations. Usually though, not always they have the right to vote for directors just as the common stockholders. **[**The par value of a share of preferred stock however is typically higher than that of common stock **(**often at N100 and N1.00 respectively**)** so a given investment in preferred stocks gains considerably than an equal investment in common stock**]**.

4.0 Conclusion

Theoretically, an enterprise should have enough debt in its capital structure to boost its return on investment by applying debt to products and projects earning more than the cost of the debt. In low earning periods, too much debt in the capital structure of an organisation can endanger stockholders' returns and jeopardise company survival. Fixed debt obligations generally must be met, regardless of circumstances. This does not mean that stock issuances are always better than debt for raising capital. Some special concerns with stock issuances are dilution of ownership, effect on stock price, and the need to share future earnings with all new shareholders.

5.0 Summary

In this unit, we examine several finance/accounting concepts considered to be central to strategy implementation: acquiring needed capital, developing projected financial statements, preparing financial budgets, and evaluating the worth of a business. Some examples of decisions that may require finance/accounting policies are these:

1. To raise capital with short-term debt, long-term debt, preferred stock, or common stock
2. To lease or buy fixed assets
3. To determine an appropriate dividend payout ratio
4. To use LIFO (last-in, first-out) or a market-value accounting approach
5. To extend the time of accounts receivable
6. To establish a certain percentage discount on accounts within a specified period of time
7. To determine the amount of cash that should be kept on hand.

6.0 Self-Assessment Exercise

Successful policy and strategy implementation often requires additional capital. Use this statement to discuss fully the issues involved in ascertain the cost of capital.

7.0 References/Further Reading

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