

Topic: Shares, Shareholders and Share Prices

3.1 What is Business?

What You Need to Know
What are shares and shareholdings?
Share prices – how determined and why they change
Market capitalisation – the value of a business
Factors that influence share prices
Raising capital through share issues

Introduction: Shareholders and Incorporated Businesses

The most important point to understand about share ownership is that an “incorporated” business (i.e. a company) is a **separate legal entity**. The owners of a company are shareholders.

There are two main kinds of company:

Private Limited Company	Public Limited Company
Most popular form of incorporated business Company is privately-owned Shares cannot be traded publicly Usually just 1 or a few shareholders Quick & cheap to set up and administer	Minimum share capital £50,000 Shares may be traded on a public stock market Usually many shareholders More detailed disclosure of information required More costly to administer

Shareholders in both private and public limited companies earn their rewards from two aspects of their business ownership: **dividends** and **capital growth**:

Dividends

- Payments made to shareholders by the company from earned profits
- Amount paid is “per share” – e.g. £1 per share held
- Normally no requirement to pay dividends, but most quoted companies do

Capital Growth (also known as Capital Gain)

- Arises from an increase in the value of the business
- Reflected in an increase in a share price
- Only realised when a share is sold (the price paid)
- No guarantee that a shareholding will increase in value – business value can change both ways

What is a Share?

A share is an individual part of the total **issued share capital** of a company. Most shares that are issued by a company are “ordinary shares”. This means:

- Equal voting rights based on number of shares held (shareholding)
- The shareholding % = the number of shares held compared with the total number of shares issues
- Shares qualify for a dividend –but, only if one is paid

To work out what shareholdings are held, you need to look at the composition of the issued share capital by shareholder and then work out the percentages. For example:

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Total Number of £1 Ordinary Shares in Issue: 20,000		
Shareholders	Number of Shares	Shareholding
Ollie	3,000	15.0%
Emma	2,500	12.5%
Jim	11,000	55.0%
Kate	1,000	5.0%
Phoebe	2,500	12.5%
Total	20,000	100%

Share Prices

A share price is the price paid to acquire ownership of that share. When shares are first issued, the price is the “issue price” (e.g. a £1 share issued for £1). Shares can be issued for more than the issue price (e.g. a £1 share issued for £10) which results in a share premium being established.

Once shares have been issued they are capable of being traded (bought and sold) either privately or using a public stock exchange. This interaction of demand (people who want to buy a share) and supply (existing shareholders who want to sell) results in the determination of a share price.

Key points to remember about share prices:

- Like any other price in a market, a share price is determined by the interaction of **supply** and **demand**
- If demand for a share > supply (more buyers than sellers) then the share price should rise
- A falling share price indicates excess supply (more sellers than buyers)

The determination of share prices for private and public limited companies also varies somewhat. The key differences are:

Share Price of Private Company	Share Price of Public Company
Initially set when shareholders “subscribe” for their shares Thereafter only determined when shares are bought or sold No active market in the shares of a private company – so hard to judge current value	Highly transparent – displayed publicly, in real-time All trades are disclosed (how many bought/sold and for what price Share prices widely published and tracked

Share Prices and Market Capitalisation

Market capitalisation represents the **total market value of the issued share capital of the company**. It is calculated using this formula:

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$$\text{Share price (per share)} \quad \times \quad \text{Number of shares in issue}$$

Factors That Influence the Share Price of a Public (Quoted) Company

The share price (and, therefore the market capitalisation) of a private company does not change regularly. The value of a private company tends only to be determined when the business itself is being bought & sold, or when new shareholders are introduced through a share issue.

By contrast, the share prices of public companies fluctuate every second whilst stock markets are open. Key factors that influence whether a share price rises or falls include:

Factors WITHIN The Company's Control	Factors OUTSIDE the Company's Control
Financial performance (e.g. profit growth) Dividend policy (how profits are distributed to shareholders) Relationship with key investors (incl. communication) Management reputation	State of the economy General market sentiment Whether the company is a takeover target Alternative investment's in the company's sector

The Importance of Market Expectations for Quoted Companies

- The share price of a quoted public company is significantly influenced by market expectations of business performance
- Unexpected warnings indicating that market expectations will not be met almost always result in a significant fall in share price
- Such bad news is known as a "profits warning"

The Role of Share Capital in Business Finance

Share capital is known as "**equity finance**" – it is the finance that is provided by those who share the equity (ownership) of a company. The main alternative to equity finance is **debt finance** – i.e. finance provided by external funders who receive a return (interest) but do not own a share of the company. The key features of equity and debt finance can be summarised as follows:

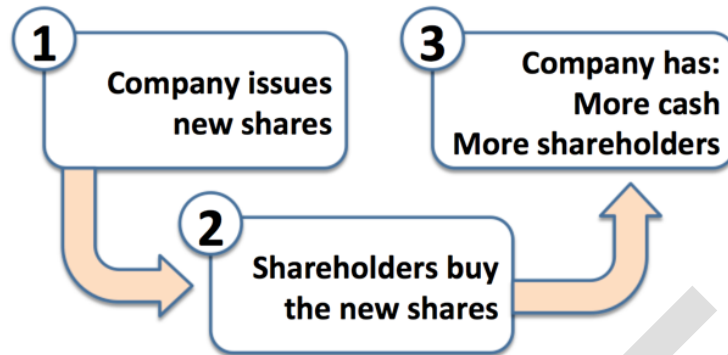
Equity Finance	Debt Finance
Returns: dividends and capital growth Part of the ownership of a company Long-term source of finance Returns tend to be higher given higher risk Can be repaid (share purchase) but this is unusual	Most commonly in the form of loans or overdrafts Return: interest on amount loaned and outstanding Repaid over an agreed period Can be short or long-term No participation in the ownership of the company Often secured against the assets of the company

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Raising Finance Through the Issue of New Shares

The issue of new share capital is a key source of finance for companies, particularly public companies whose shares are traded on a stock market.



The two main methods of issuing new shares for a public company are:

Flotation	Share issued on Stock Exchange for the first time Opportunity for existing shareholders to realise profits on their investment Costly + time-consuming process Typically aims to raise at least £25-50 million + of new capital
Rights issue	Fresh issue of new shares to existing shareholders Shareholders have the "right" to subscribe for the new shares, usually at a significant discount to the existing share price Often done to help finance a major expansion (e.g. takeover) or to help refinance a business in difficulty

The main benefits and drawbacks of raising finance through the issue of new shares include:

Benefits	Drawbacks
Able to raise substantial funds if the business has good prospects	Can be costly and time-consuming (particularly a flotation)
Broader base of shareholders	Existing shareholders' holdings may be diluted
Equity rather than debt = lower risk finance structure	Equity has a cost of capital that is higher than debt

Key Terms

Market capitalisation	The total market value of the issued share capital of a company based on the latest share price
Flotation	The admission of the shares of a public company to a stock exchange and subsequent trading in those shares

Topic: Segmentation, Targeting & Positioning
 3.3 Decision-making to Improve Marketing Performance

What You Need to Know
Types and use of market segmentation
Benefits and drawbacks of segmentation
Niche and mass markets
Choosing a target market
Product differentiation
Market positioning

Introduction to Marketing Strategy

Businesses use marketing to create value for customers by making two key decisions:

Decision 1: Choose which customers to serve

This involves two elements:

- **Market segmentation** (analysing the different parts of a market)
- **Targeting** (deciding with market segments to enter)

Decision 2: Choose how to serve those customers

This also involves two important parts of marketing strategy:

- **Product differentiation** (what makes it difference from the competition)
- **Marketing positioning** (how customers perceive the product)

Market Segmentation

Market segmentation involves dividing a market into **parts that reflect different customer needs and wants**.

Segmentation is possible because in almost all markets there are differences in factors such as:

- Customer needs & wants
- How customers buy
- Location of customers
- Knowledge & experience of customers

Recognising and understanding these differences are the first steps in an effective approach to market segmentation.

Four traditional ways (bases) of segmenting a market are:

SEGMENT BASIS	SUMMARY
DEMOGRAPHIC	Dividing a market into segments based on demographic variables such as age, gender, family lifestyle, religion, nationality ethnicity etc.
INCOME	Dividing markets into different income segments, often on the basis of social-economic grouping
BEHAVIOURAL	Dividing a market into segments based on the different ways customers use or respond to a product and the benefits they seek
GEOGRAPHICAL	Dividing a market into different geographical units, such as nations, regions, cities, neighbourhoods or other territories

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Benefits and Drawbacks of Market Segmentation

Among the key benefits are that segmentation:

- Focuses resources on parts of a market where the business can succeed
- Allows a business to grow share in markets or to “ride the wave” of fast-growing segments
- Helps with new product development – focused on needs of customers in the segment
- Helps make the marketing mix more effective – e.g. better targeting of promotion

On the other hand:

- Segmentation is an imprecise science – data about each market segment is not always available, up-to-date or reliable
- Just because you can identify a segment doesn’t mean you can reach the customers in it!
- Markets are increasingly dynamic – fast-changing; so too are the segments

Niche and Mass Markets

Another way of analysing the differences between markets is to make a distinction between **niche** and **mass** markets. This is a similar idea to market segmentation, although it is based more on the overall characteristics of a market (e.g. size, extent of product differentiation) than other ways in which customer needs and wants are different.

Niche Marketing	Where a business targets a smaller segment of a larger market , where customers have specific needs and wants
Mass Marketing	Where a business sells into the largest part of the market , where there are many similar products offered by competitors

The key features of a mass market (reverse these to identify key features of a niche) are:

- Customers form the majority in the market
- Customer needs and wants are more “general” & less “specific”
- Associated with higher production output and capacity + potential for economies of scale
- Success usually associated with low-cost (highly efficient) operation or market leading brands

So, given that a mass market is a larger opportunity, why might a business want to target a niche? As with all marketing choices there are potential benefits and drawbacks:

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Advantages of Targeting a Niche	Disadvantages of Targeting a Niche
Less competition - a “big fish in a small pond” Clear focus - target particular customers Builds up specialist skill and knowledge Can often charge a higher price Profit margins often higher Customers tend to be more loyal	Lack of economies of scale Risk of over dependence on a single product or market Likely to attract competition if successful Vulnerable to market changes – all “eggs in one basket”

Strategies for Choosing the Target Market

A target market is the **set of customers sharing common needs and wants that a business ties to connect with.**

There are three main kinds of approaches to market targeting:

STRATEGY	OVERVIEW
Mass marketing (undifferentiated)	<ul style="list-style-type: none"> • Business targets the WHOLE market, ignoring segments • Products focus on what customers need and want in common, not how they differ
Segmented (differentiated)	<ul style="list-style-type: none"> • Business target several market segments within the same market • Products are designed and targeted at each segment • Requires separate marketing plans and often different business units & product portfolios
Concentrated (niche)	<ul style="list-style-type: none"> • Business focuses narrowly on smaller segments or niches • Aim is to achieve a strong market position (share) within those niches

Market Positioning

Having chosen which segments to target – the next stage of the marketing strategy is to decide how to compete in those segments. Marketing people call this choice the **value proposition.**

It is important to remember that the market position (or value proposition) is defined by customers – the place a product occupies in customer minds relative to competing products.

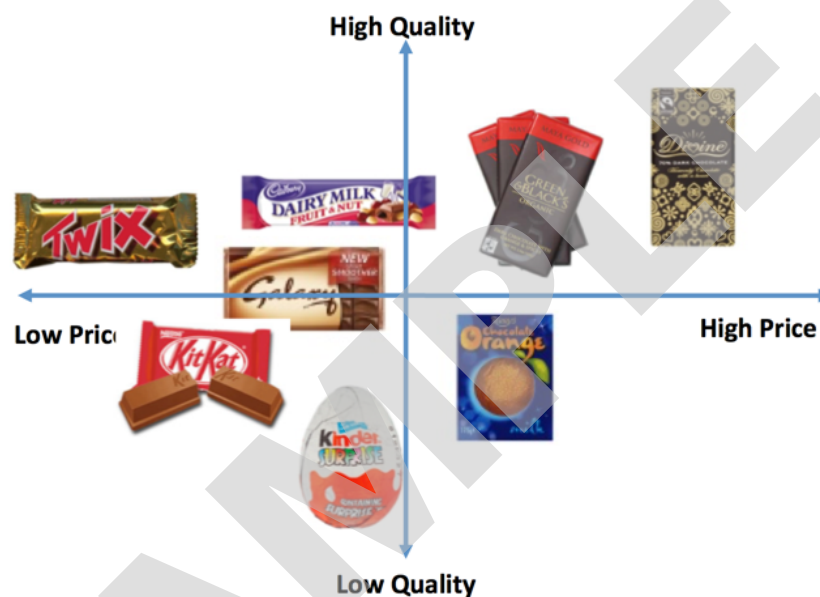
A useful framework for analysing market positioning is a “**positioning map**”. A market (or positioning) map illustrates the range of “positions” that a product can take in a market based on two dimensions that are important to customers.

Some possible dimensions for the axes of a positioning map include:

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Dimensions	
Low price	High price
Basic quality	High quality
Low volume	High volume
Necessity	Luxury
Light	Heavy
Simple	Complex
Unhealthy	Healthy
Low-tech	Hi-tech

An example of a positioning map for chocolate bars might look like this:



Whilst positioning maps are useful conceptual models, care has to be taken when using them in marketing decision-making:

- **Advantages of positioning maps**
 - Helps spot gaps in the market
 - Useful for analysing competitors
 - Encourages use of market research
- **Disadvantages of positioning maps**
 - Just because there is a “gap” doesn’t mean there is demand
 - Not a guarantee of success
 - How reliable is the market research?

Market Positioning and Competitive Advantage

Remember that customers choose products based on their perception of a product’s value proposition – how they perceive the merits of the product relative to the alternatives (competing products).

Therefore, providing a superior value proposition than the competition is a likely source of competitive advantage – but only if it can be sustained.

There are various possible value differences that have the potential to deliver competitive advantage:

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Offer more for less	E.g. Aldi: good quality at low prices
Offer more for more	E.g. high-priced luxury products with prestige value
Offer more for the same	E.g. introduce new features & better performance for the same price
Offer less for much less	E.g. no-frills low cost flying and hotels; good quality, back to basics & low price

Product Differentiation

Product differentiation arises when customers perceive a distinct difference between your product and the alternatives provided by competitors. Effective differentiation allows a business to:

- **Compete effectively**
 - A source of competitive advantage
 - Ideally hard to copy
- **Protect and build a brand**
 - Build intangible value
 - Strengthen customer loyalty
- **Add more value**
 - Strong differentiation should allow a higher price
 - Higher profit margins

The key requirements for effective product differentiation are that the product is:

- Delivers things that are important to customers
- Distinctive – compared with the competition
- Communicated and visible to customers
- Not easily copied by competitors
- Affordable by the target customers
- Profitable

A product that is effectively positioned is often said to have a USP (unique selling point). A USP is something that sets a product apart from its competitors in the eyes of customers, both new and existing.

Key Terms

Market segmentation	Involves dividing a market into parts that reflect different customer needs and wants.
Niche market	A smaller segment of a larger market , where customers have specific needs and wants & successful products are highly differentiated
Mass market	The largest part of the market , where there are many similar (undifferentiated) products offered by competitors
Target market	The set of customers sharing common needs and wants that a business tries to connect with
Product differentiation	Where a product has a value proposition that is sustainably different from the competition

Topic: Capacity Management

3.4 Decision Making to Improve Operational Performance

What You Need to Know
Meaning & importance of capacity
Calculation and interpretation of capacity utilisation
How to use capacity efficiently

Introduction to Capacity

The **capacity** of a business is a measure of how much **output** it can achieve in a given period. For example:

- A fast-food outlet may be able to **serve 1,000 customers per hour**
- A call-centre may be able to **handle 10,000 calls per day**
- A football stadium could seat no more than **45,000 fans at each match**
- A car production line may be able to complete **50,000 cars per year**

Capacity is therefore a measure of “potential” output. Of course, not every business will be able to operate to full potential; and sometimes a business will find demand so high that it does not have sufficient capacity.

Why Capacity is Important

How capacity is managed has a direct effect on the performance of a business. In order for a business to be able to meet **demand** from customers, it needs to have the **capacity** to do so. Having capacity enables orders to be met and revenues generated. However, a lack of capacity can have a damaging effect on business performance. For example, a restaurant will lose sales if customers turn away seeing all the tables full; a factory may lose an order if it is not able to produce the volume required for a possible order.

The Costs of Capacity

Since capacity is all about the **output a business can achieve**, it is easy to see what costs are involved in making that capacity available. The key costs of capacity are:

Equipment: e.g. production line

Facilities: e.g. building rent, insurance

Labour: wages and salaries of employees involved in production or delivering a service

There is an important link between capacity and unit costs, since unit costs are calculated using the actual output during a period. This link is a key concept called **capacity utilisation**.

Capacity Utilisation

Capacity utilisation measures the extent to which capacity is used during a specific period. For example:

- A frozen pizza production line might make 75,000 pizzas in a week compared with its capacity of 100,000 per week
- A beauty salon could complete 300 appointments in a month compared with a potential of 500 appointments per month.

Where both actual and potential output can be measured, capacity utilisation can be calculated and it is **expressed as a simple percentage** using this formula:
Capacity utilisation = the percentage of total capacity that is actually being achieved in a given period

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(Actual output / potential output) x100

Example of Capacity Utilisation Calculation

Kaur Components manufactures printed circuit boards for use in remote monitoring devices. Working a normal two-shift rota, the Kaur factory is capable of producing 150,000 circuit boards per month. In the latest month, actual output was 127,500 units. What was the capacity utilisation for that month?

Actual Output: 127,500 units

Potential Output (Capacity): 150,000 units

Capacity Utilisation = $127,5000 / 150,000 = 85\%$

Capacity utilisation is an important concept because:

- It is a useful measure of productive efficiency since it measures whether there are idle (unused) resources in the business;
- Average production costs tend to fall as output rises – so higher utilisation can reduce unit costs, making a business more competitive
- Businesses usually aim to produce as close to full capacity (100% utilisation) as possible in order to minimise unit costs
- A high level of capacity utilisation is required if a business has a high break-even output due to significant fixed costs of production

Reasons Why Businesses Operate Below Full Capacity

Most businesses have some **spare capacity** – i.e. they operate at below their capacity (i.e. less than 100% capacity utilisation). This happens for a variety of reasons:

Reason	Example
Lower than expected market demand	A change in customer tastes
A loss of market share	Competitors gain customers
Seasonal variations in demand	Weather changes lead to lower demand
Recent increase in capacity	A new production line has been added
Maintenance and repair programmes	Capacity is temporarily unavailable

If a business operates **consistently at a low level of capacity utilisation**, this is likely to indicate potentially serious issues, particularly if production costs are mainly fixed and the business has a high break-even output. Persistently low levels of capacity utilisation are likely to result in the business having higher unit costs than other competitors that may therefore result in the business being less competitive.

Drawbacks of High Capacity Utilisation

Although there are benefits of operating at a high level of capacity utilisation, there are also possible drawbacks. Possible issues include:

- There is less time for productive equipment and facilities to be maintained and repaired, which may increase the likelihood that they break-down in the future;
- Employees involved in production are out under greater stress and pressure which can be counter-productive if, for example, they become demotivated or it contributes to an increase in absenteeism;

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- Customer service may deteriorate if, for example, customers have to wait longer to be served or to receive their product
- A business is less likely to be able to respond to sudden or unexpected increases in demand

Options to Increase Capacity

What happens if a business finds itself with **excess demand** (i.e. it does not have enough capacity to meet demand). In such circumstances, what can it do to operate at higher than 100% normal capacity? Possible options might include:

- Increase workforce hours (e.g. extra shifts; encourage overtime; employ temporary staff)
- Sub-contract some production activities (e.g. assembly of components)
- Reduce time spent maintaining production equipment

Key Terms

Capacity	The potential output of a business measured in terms of units of output over a specific period
Capacity utilisation	The proportion (percentage) of a business' capacity that is actually being used over a specific period
Spare (excess) capacity	Where actual output is less than capacity
Excess demand	Where demand for a business' products or services is greater than the business capacity