

Edexcel

A Level

Business studies

(Code: WEC13 01)

Unit 03-Section 05

Assessing competitiveness



17. Interpretation of financial statements

FINANCIAL STATEMENTS

All companies are required by law to produce financial statements at the end of the financial year - although many public limited companies (plcs) produce them on a quarterly basis (i.e. four times per year). According to the International Accounting Standards Board, the body responsible for developing and approving international financial reporting standards, the following statements are required.

- A statement of financial position (balance sheet), which shows the assets, liabilities and capital of the business.
- A statement of comprehensive income (profit and loss account), which starts with the profit or loss for the year and then shows other items of comprehensive income, such as gains made on currency transactions.

THE STATEMENT OF COMPREHENSIVE INCOME

The statement of comprehensive income is used by most plcs to show the income and expenditure of the business for a period of time (usually one year) and calculate the profit made by the business. The financial information has to be presented in a standard way. An example for a limited company, Cattle Snaffle Ltd, is shown in Table 3. Cattle Snaffle Ltd supplies cattle and sheep feed to farmers in the EU.

Key information:

The statement of comprehensive income contains the following information.

- **Revenue.** This is the money the business receives from selling goods and services. It is sometimes called turnover. Revenue must not include VAT. This is because VAT does not belong to the business. The revenue for Cattle Snaffle Ltd in 2017 was €25.4 million.
- **Cost of sales.** This refers to the production costs of a business. It relates to direct costs in particular, such as raw materials and labour. In the case of Cattle Snaffle Ltd, the cost of sales would be the cost of grain, nutrients, electricity, wages to factory workers and any sales taxes paid such as VAT..
- **Gross profit.** This is the cost of sales subtracted from the revenue. It is the profit made before the deduction of general overheads. The gross profit made by Cattle Snaffle Ltd in 2017 was €13.1 million (€25.4 million - €12.3 million).
- **Selling expenses.** A business is likely to have a range of expenses from the selling of its products. Examples might include sales commissions, advertising, distribution and promotional costs. In 2017, Cattle Snaffle Ltd spent €3.2 million on selling expenses.
- **Administrative (admin) expenses.** These are the general overheads or indirect costs of the business. Examples might include office salaries, expenses claimed by senior staff, stationery supplies, IT expenses, accountancy fees and telephone bills. Cattle Snaffle Ltd incurred administrative expenses of €6.4 million in 2017.

	2017 (€m)	2016 (€m)
Revenue	25.4	21.2
Cost of sales	12.3	11.7
Gross profit	13.1	9.5
Selling expenses	3.2	2.3
Admin expenses	6.4	5.2
Operating profit	3.5	2.0
Finance costs	0.4	0.4
Profit for the year (net profit)	3.1	1.6
Taxation	0.6	0.3
Profit for the year (net profit) after taxation	2.5	1.3

▲ Table 3 Extract from the statement of comprehensive income for Cattle Snaffle Ltd, year ending 31/12/17

- **Operating profit.** The operating profit is gross profit minus selling and administrative costs. It is the profit generated from the firm's core activities. It does not include any income from financial investments made by the business. Cattle Snaffle Ltd made an operating profit of €3.5 million in 2017.

- **Finance costs.** If a business borrows money, it will have to pay interest to the lender. The amount paid will be entered in the statement of comprehensive income as a finance cost.

- **Profit for the year (net profit).** The net profit for the year is operating profit minus the cost of finance. This is the profit before taxation. Cattle Snaffle Ltd made a profit for the year (net profit) of €3.1 million in 2017.

- **Profit for the year (net profit) after tax.** This is the amount of money that is left over after all expenses, including taxation, have been deducted from revenue. It is often referred to as the 'bottom line'. The money belongs to the owners of the business. In the case of a limited company, it belongs to the shareholders.

	2018 (VND)
Revenue	980 000
Cost of sales	430 000
Gross profit	550 000
Selling expenses	110 000
Admin. Expenses	130 000
Operating profit	310 000
Finance costs	80 000
Profit for the year (net profit)	230 000

▲ Table 4 Example statement of comprehensive income

STAKEHOLDER INTEREST

Shareholders: Obviously, the owners of a business are interested in its performance. Shareholders are likely to be interested in the profit made by the business, particularly the profit for the year (net profit) after tax. This is an effective guide to the performance of a business but not the only guide.

Managers and directors: Since managers and directors are responsible for running the business, they are likely to use key information in the statement of comprehensive income to monitor progress.

Employees: If employees (or their representatives) want a wage increase, it may be helpful to have access to some of the information in the statement of comprehensive income when presenting a claim.

Suppliers: Before a supplier accepts an order from a new customer on trade credit, it is sensible to check their creditworthiness (i.e. their ability to pay for what they have bought on credit). One way to do this is to look at the trading history of the customer.

The government: Companies have to produce a statement of comprehensive income by law. It is needed by the tax authorities to help assess how much tax a business has to pay. The tax authorities collect taxes on behalf of the government and require all business owners to provide documentary evidence of the profits or losses made by the business every year.

STATEMENT OF FINANCIAL POSITION

The statement of financial position (balance sheet) provides a summary of a firm's assets, liabilities and capital. It is like a photograph of the financial position of a business at a particular point in time.

- **Assets.** Assets are the resources that a business owns and uses. Assets are usually divided into current assets and non-current assets. Current assets are used up in production, such as stocks of raw materials. They can also be money owed to the business by debtors.

- **Liabilities.** Liabilities are the debts of the business, i.e. what it owes to other businesses, individuals and institutions. Liabilities are a source of funds for a business. They might be short term, such as an overdraft, or long

term, such as a mortgage. In the balance sheet, liabilities are divided into current liabilities and non-current liabilities.

- **Capital.** This is the money introduced by the owners of the business, for example when they buy shares. It is another source of funds and can be used to purchase assets.

KEY INFORMATION

The key information that is likely to be listed in a statement of financial position is shown in Table 6. It shows the assets, liabilities and capital of Cattle Snaffle Ltd, the cattle and sheep feed producer mentioned earlier. Non-current assets: Non-current assets are any assets that are not expected to be sold within 12 months. They are the long-term resources of the business. A number of entries are likely to be found in this section of the balance sheet.

- **Goodwill.** This is an example of an intangible asset. This is a non-physical asset of a business (i.e. it is not a visible asset). It is the amount the business is worth above the value of net assets. Goodwill exists if a company has built up a good reputation and its customers are likely to return.

- **Other intangible assets.** These may appear in some plc balance sheets.

- **Property, plant and equipment.** These are the tangible assets that the business owns. Tangible assets are the physical assets of a business.

- **Investments.** These are the financial assets owned by the company.

Current assets: Current assets are the liquid assets that belong to the business. Liquid assets are either cash or are expected to be converted into cash within 12 months.

- **Inventories.** This refers to stocks of raw materials and components, stocks of finished goods and work in progress. For Cattle Snaffle Ltd, examples might be grain, such as barley and wheat, nutrients and packaging. The value of Cattle Snaffle's inventories in 2017 was €8.6 million.

- **Trade and other receivables.** These are trade debtors, prepayments and any other amounts owed to the business that are likely to be repaid within 12 months.

- **Cash at bank and in hand.** This is the money held by a business on the premises or in bank accounts.

Current liabilities: Any money owed by the business that is expected to be repaid within 12 months is called a current liability. Some examples are outlined below.

- **Borrowings.** Any short-term loans or bank overdrafts taken out by the business. In this case, Cattle Snaffle does not have any short-term loans.

	2017 (€m)	2016 (€m)
Non-current assets		
Goodwill	30.5	27.8
Other intangible assets	15.2	11.6
Property, plant & equipment	97.7	94.1
Total non-current assets	143.4	133.5
Current assets		
Inventories	8.6	6.7
Trade and other receivables	3.4	3.1
Cash and cash equivalents	3.1	2.7
Total current assets	15.1	12.5
Total assets	158.5	146.0
Current liabilities		
Trade and other payables	5.5	5.1
Dividends payable	1.2	0.8
Current tax liabilities	6.7	5.7
Total current liabilities	13.4	11.6
Non-current liabilities		
Borrowings	24.5	26.1
Provisions	4.1	3.4
Pensions	7.8	6.7
Total non-current liabilities	36.4	36.2
Total liabilities	49.8	47.8
Net assets	108.7	98.2
Shareholders' equity		
Share capital	30.0	30.0
Other reserves	17.7	9.7
Retained earnings	61.0	58.5
Total equity	108.7	98.2

▲ Table 6 Statement of financial position for Cattle Snaffle Ltd, as at 31/12/17

- **Trade and other payables.** Trade creditors and other amounts owed by the business to suppliers of goods, services and utilities (such as electricity, gas, water, cable and telephone), for example. Table 6 shows that Cattle Snaffle owed €5.5 million to its suppliers in 2017.
- **Dividends payable.** It is possible that the company has decided how much it will pay to the shareholders in dividends when the balance sheet is prepared. However, the money has not yet been paid so it appears in the balance sheet as dividends payable.
- **Current tax liabilities.** Corporation tax, employees' income tax and any other tax owed by the business that must be repaid within 12 months.

Non-current liabilities: These are the long-term liabilities of a business. Any amount of money owed for more than one year will appear in this section of the balance sheet.

- **Other loans and borrowings.** Money owed by the company that does not have to be repaid for at least 12 months. Examples would be long-term bank loans and mortgages. Table 6 shows that Cattle Snaffle Ltd owed €24.5 million in 2017.
- **Retirement pension obligations.** Companies need to show any money owed to past employees in the form of pension obligations. In 2017 Cattle Snaffle Ltd had €7.8 million in pension commitments.
- **Provisions.** Provisions have to be made if a company is likely to incur (i.e. owe) expenditure in the future. Such expenditure might occur as a result of agreements in contracts or warranties. An example for Cattle Snaffle Ltd might be a possible bad debt that it may incur. If these provisions are short term they will appear under current liabilities.

Net assets: Net assets is the value of all assets minus the value of all liabilities. It will be the same value as shareholders' equity at the bottom of the balance sheet. The value of Cattle Snaffle's net assets in 2017 was €108.7 million. The net assets provide a guide to the value of a business.

Equity: The bottom section of the balance sheet shows the amounts of money owed to the shareholders. It will contain details of share capital and reserves.

- **Share capital.** The amount of money paid by shareholders for their shares when they were originally issued. It does not represent the current value of those shares on the stock market. Share capital is not usually repaid to the shareholders in the lifetime of a company. The value of Cattle Snaffle's issued share capital in 2017 was €30 million.
- **Share premium account.** This shows the difference between the value of new shares issued by the company and their nominal value.
- **Retained earnings.** The same as retained profit. It is the amount of profit kept by the business to be used in the future, for example to fund investment projects.

STAKEHOLDER INTEREST

The statement of financial position can be used to help evaluate the performance of a business. It shows different information from that of the statement of comprehensive income, and stakeholders are likely to be interested in both statements together.

Shareholders: The balance sheet is a crucial tool for shareholders to analyze a business's asset structure, capital structure, and solvency. For instance, Cattle Snaffle Ltd's balance sheet shows that over 60% of assets are invested in property, plant, and equipment. The balance sheet also helps assess the business's liquidity, with the working

capital value of €1.7 million, which may be considered inadequate due to the insufficient coverage of current liabilities.

Managers and directors: The balance sheet might be used by the management of a business. For example, it is important for senior managers to be aware of the firm's financial position at all times. It will need to monitor working capital levels to ensure that the business does not overspend. Also, if the business is considering raising some more finance, it will have to consider the current capital structure before choosing a suitable source.

Suppliers and creditors: Suppliers will be most interested in the solvency of the business. Suppliers are not likely to offer trade credit to a business that only has a limited amount of working capital. Cattle Snaffle Ltd only has a small amount of working capital; as a result, it might struggle to get generous trade credit terms.

Others: It is possible that employees might use the balance sheet to assess whether a business can afford a pay rise or whether their jobs are secure. Government agencies responsible for gathering statistics might also extract information from the balance sheet to compile national statistics.

SUBJECT VOCABULARY

administrative expenses costs relating to running a business
debtors people or businesses that owe money
finance cost interest paid by a business on any borrowed money
finance income interest received by a business on any money held in deposit
patent a government authority or licence for a right or title for a set period of time. This involves the sole right to exclude others from making, using or selling a product, service or idea
solvency (solvent) the ability of a business to meet its debts

18 Ratio analysis

FINANCIAL RATIOS

It is possible to find important information from the statement of comprehensive income and the statement of financial position to help assess the performance of a business. This approach was used in Chapter 17. However, a more thorough approach is to use **ratio analysis**.

PROFITABILITY RATIOS

Profitability or performance ratios help to show how well a business is doing. They may be used by senior managers, the finance department and investors to help assess the performance of the business.

The profit figure alone is not a useful **performance indicator**. We must look at the value of profit in relation to the value of revenue or the amount of money that has been invested in the business. A business can use a variety of different profitability ratios.

Gross profit margin: The gross profit margin shows the gross profit made on sales turnover/revenue. It is calculated using the formula:

$$\text{Gross profit margin} = \frac{\text{Gross profit} \times 100}{\text{Revenue}}$$

Profit for the year (net profit) margin: The profit for the year (net profit) margin or net profit margin takes into account all business costs, including finance costs, other non-operating costs and exceptional items. It is also usually calculated before tax has been subtracted. The profit for the year (net profit) margin can be calculated by:

$$\text{Profit for the year (net profit) margin} = \frac{\text{Net profit before tax} \times 100}{\text{Revenue}}$$

INTERPRETING PROFITABILITY RATIOS

Gross margin: Higher gross margins yield more profit per £1 of sales, and this varies across industries. Fast inventory turnover leads to lower margins, while supermarkets with regular inventory turnover can achieve success with low margins. Washytree Holdings' gross profit margin increased from 41% to 45% over two years, likely pleasing managers and owners.

Profit for the year (net profit) margin: Again, higher margins are better than lower ones. The profit for the year (net profit) margin focuses on the 'bottom line' in business. The bottom line refers to the very last line in the statement of comprehensive income. It shows the profit that is left after all deductions have been made, i.e. the final amount of profit left over for the owners.

LIQUIDITY RATIOS

Information contained in the balance sheet can be used to measure the liquidity of a business. It is important that a business is able to meet its short-term debts. This means that a business must have enough liquid resources to pay its immediate bills. If it doesn't, it might result in the financial collapse of the business. Two financial ratios can be used to measure liquidity.

Current ratio: The current ratio is a liquidity ratio and focuses on the current assets and current liabilities of a business. It can be calculated using the formula:

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

Acid test ratio: The acid test ratio is a more severe test of liquidity. This is because inventories are not treated as liquid resources. There is no guarantee that inventories can be sold, and they may become outdated or decline in quality. They are therefore excluded from current assets when calculating the ratio. The acid test ratio can be calculated using the formula:

$$\text{Acid test ratio} = \frac{\text{Current assets} - \text{Inventories}}{\text{Current liabilities}}$$

INTERPRETING LIQUIDITY RATIOS

Current ratio: A business has enough liquid resources if its current ratio is between 1.5:1 and 2:1. A ratio below 1.5 indicates insufficient working capital, while a ratio above 2:1 suggests unproductive use of resources. For example, Washytree Holdings' current ratio improved from 1.39 to 1.63 between 2016 and 2017, moving into the safe range.

Acid test ratio: An acid test ratio of less than 1:1 indicates a potential problem if a business's current assets minus stocks don't cover its current liabilities. However, strong cash flows can operate comfortably with an acid test ratio. Washytree Holdings' ratio improved from 0.81 in 2016 to 1.06 in 2017, indicating improved liquidity.

GEARING RATIOS

Gearing ratios indicate a business's long-term financial position, relating interest payments to loans and dividends to shareholders' equity. They connect non-current liabilities to capital employed, which can be determined by subtracting current liabilities from total assets.

The formula is:

$$\text{Gearing ratio} = \frac{\text{Non-current liabilities}}{\text{Capital employed}} \times 100\%$$

INTERPRETING THE GEARING RATIO

Creditors are concerned about a firm's gearing ratio, which is the ratio of a company's loan capital to its share capital. High gearing ratios are considered riskier by creditors, as they require repayment of interest charges and dividends. Gearing ratios help analyze a business's capital structure by comparing capital raised from ordinary shareholders with loans. Washytreet Holdings' gearing ratio is relatively low, but concerns are raised when it reaches 50%. A low gearing ratio ensures the business is not overburdened with long-term debt.

RETURN ON CAPITAL EMPLOYED (ROCE)

One of the most important ratios used to measure the profitability of a business is the **return on capital employed (ROCE)**. This is sometimes referred to as the primary ratio. Creditors are concerned about a firm's gearing ratio, which is the ratio of a company's loan capital to its share capital. High gearing ratios are considered riskier by creditors, as they require repayment of interest charges and dividends. Gearing ratios help analyze a business's capital structure by comparing capital raised from ordinary shareholders with loans. Washytreet Holdings' gearing ratio is relatively low, but concerns are raised when it reaches 50%. A low gearing ratio ensures the business is not overburdened with long-term debt.

ROCE can be calculated using the formula:

$$\text{ROCE} = \frac{\text{Operating profit}}{\text{Capital employed}} \times 100\%$$

INTERPRETING ROCE

Washytreet Holdings' ROCE increased from 25.5% to 27.4% over two years, indicating impressive performance. However, comparisons with other businesses and potential returns from investments like a bank account are needed. The \$23977 000 invested by shareholders in Washytreet Holdings is at risk, so the ROCE must be greater than a safe investment like a bank deposit account.

LIMITATIONS OF RATIO ANALYSIS

Unfortunately, there are problems with ratio analysis, so it must be used carefully. Some of the key limitations are outlined here.

The basis for comparison: We must be careful making comparisons using ratios. It is very important to compare 'like with like'.

- **Comparisons over time.** Comparing ratios from the same company over time is crucial due to factors such as industry variation, size changes, and the value of a specific ratio. For instance, a small company's performance may change as it grows, making it essential to consider these changes when comparing ratios.

- **Inter-firm comparisons.** We must be careful as we compare ratios between companies at a point in time. Comparing the ratios of two companies that make the same products is likely to say something about their relative performance. But comparing the ratios of a supermarket chain with those of a cement manufacturer is unlikely to be helpful. For example, the two companies will have different working capital needs and different profit margins. Even companies operating in the same industry can have subtle differences.

- **Other differences.** Even when companies have similar activities and operating circumstances, there may be other differences between them.

The quality of final accounts: Ratios are based on financial accounts, and their accuracy depends on the accuracy of the accounts. Inflation can affect the quality of accounting information, as rising prices can misrepresent comparisons between time periods.

Limitations of the balance sheet: The balance sheet is an outline of the business at the end of the financial year. This means it might not be representative of the business's circumstances throughout the whole of the year. For example, if a business experiences its peak trading activity in the summer, and it has its year end in January when trade is slow, figures for stock and debtors will be unrepresentative.

Qualitative information is ignored: Ratios only use quantitative information. However, some important qualitative factors may affect the performance of a business that are ignored by ratio analysis.

Window dressing: Accounts must represent a 'true and fair record' of the financial affairs of a business. Legislation and financial reporting standards place limits on the different ways in which a business can present financial information.

- Managers of companies might want to put as good a financial picture forward as possible for shareholders and potential shareholders. Good financial results will attract praise and perhaps rewards. They might also prevent criticism from shareholders and the media.
- If a business wants to raise new capital from investors, then it will want its financial accounts to look as good as possible.
- If a business has experienced severe difficulties during the accounting period, it may decide to take action. The action might make the financial position look even worse now, but it will improve figures in the future.
- Making the financial picture look worse may also be a way of lowering the amount of tax that is paid.
- If the owners of a business want to sell it, the better the financial position shown on the accounts, the higher the price they are likely to get.

SUBJECT VOCABULARY

fraud the illegal act of cheating somebody to get money
gearing the ratio of a company's loan capital to its share capital
gearing ratios explore the capital structure of a business by comparing the proportions of capital raised by debt and equity
performance indicator a type of performance measurement that evaluates the success of an organisation or of a particular activity
profitability or performance ratios illustrate the profitability of a business compared to other business
ratio analysis to investigate accounts by comparing two connected figures
return on capital employed (ROCE) the profit of a business as a percentage of the total amount of money used to generate it
window dressing the legal adjusting of accounts by a business to present a financial picture that is to its benefit

19 Human resources

LABOUR PRODUCTIVITY

Labour productivity is defined as output per worker over a given period of time. As a formula:

$$\text{Labour productivity} = \frac{\text{Total output (per period of time)}}{\text{Average number of employees (per period of time)}}$$

However, businesses sometimes find that they become less competitive despite increasing their labour productivity. This may happen for a number of reasons.

- Rival businesses may increase their productivity at an even faster rate.
- New rival businesses may set up and pay lower wages. Many European manufacturing businesses have become less competitive over the past ten years. This is due to the rise of competition
- Other factors apart from cost may affect a business.

LABOUR TURNOVER

Labour, or staff, turnover is another measure of how effective personnel is. Labour turnover is the proportion of staff leaving a business compared to the number of staff staying over a period of time. It is measured by the formula:

$$\text{Retention rate} = \frac{\text{Number of staff leaving (over a time period)}}{\text{Average number of staff in post (in the time period)}} \times 100\%$$

Disadvantages of high labour turnover: High labour turnover is usually seen as a problem for businesses for a number of reasons.

- Recruiting new staff can be costly.
- It takes time for new staff to become familiar with their roles and how the business operates. High labour turnover is likely to reduce the human process advantage of a business.
- Larger companies may put on induction programmes to welcome employees, which adds to the costs.
- If the post is filled from within the business, there may be training needs for the worker who gets the job.

Advantages of high labour turnover: Despite the drawbacks outlined above, some labour turnover is beneficial to a business.

- New staff can bring in fresh ideas and experience from their work with other businesses.
- Some workers may be ineffective in their current job and need to be encouraged to leave. Getting rid of ineffective staff leads to labour turnover.
- If a business is shrinking in size, reducing the size of the workforce will lead to higher labour turnover.
- Where a business pays low wages, or where conditions of work are poor, it may be more profitable to have a constant turnover of staff rather than raise wages or improve conditions of work.

LABOUR RETENTION

Labour retention and labour turnover are related. This is because labour turnover looks at the rate at which employees leave a business, while labour retention looks at the rate at which they stay with the business. Therefore, labour retention is the opposite of labour turnover. It can be calculated using the following formula:

$$\text{Labour retention} = \frac{\text{Number of staff staying (over a time period)}}{\text{Average number of staff in post (in the time period)}} \times 100\%$$

ABSENTEEISM

Absenteeism is a problem for all businesses for a number of reasons.

- Staff who are absent often claim to be ill so that, normally, the business then has to pay sick pay.
- If temporary staff are brought in to cover for absent staff, this leads to increased costs. Equally, costs will increase if permanent staff have to work overtime. They are often paid at higher rates than their basic rate of pay.
- Output may suffer if workers are expected to cover for sick colleagues or if temporary staff are not as productive as the absent workers.
- Continued absences can cause problems if the worker is very important to a particular area of work or a new project.
- Customers can be lost if production is delayed or there are problems with quality.
- Absenteeism can demotivate the staff (i.e. make them feel like it is not worth making an effort) who are left to cope with problems.

The higher the rate of absenteeism, the more likely it is that workers will report ill. This is because a culture of absenteeism will develop, making it acceptable for workers to take extra days holiday by reporting in sick.

The rate of absenteeism: The rate of absenteeism (absenteeism rate or absentee rate) can be calculated by dividing the number of staff who are absent by the total number of staff employed. The rate is expressed as a percentage. It can be calculated as a daily rate using the formula:

$$\frac{\text{Number of staff absent on a day}}{\text{Total number of staff employed}} \times 100$$

Annual rate of absenteeism: It is also possible to calculate the annual rate of absenteeism. Rates of absenteeism can be calculated for a business as a whole and compared to industry averages or national averages. They can also be compared between one part of a business and another or compared over time. Differences in rates of absenteeism occur for a number of reasons.

- Small businesses tend to have lower rates of absenteeism than larger businesses. This is because there is much more commitment and teamwork in a small business than in a large business.
- Health and safety is a factor. Businesses that have good health and safety procedures will tend to suffer less illness-related absenteeism than those with poor procedures. Equally, some jobs are more dangerous to health than others and so absenteeism is more likely.

- The nature of the tasks given to workers is another factor. For example, tasks that are repetitive lead to low job satisfaction and to workers not feeling motivated. This encourages them to report sickness. Workers in jobs which are interesting and rewarding tend to have lower absentee rates.
- The culture of a workplace can cause absenteeism. If workers are overworked, with bosses who make them feel nervous or frightened and ignore workers' needs, work-related stress is much more common. Workers who are off through stress are a problem because they often take months off work at a time.
- Stress-related illness is also more common where workers are over-supervised. They feel that they are not trusted by their bosses to carry out tasks.
- Workers who feel that they are not paid enough are more likely to take time off work. They may see it as compensation (i.e. something that makes a bad situation better) for the lack of money they receive. Low pay can also demotivate workers and so contributes to absenteeism.

LIMITATIONS OF LABOUR PRODUCTIVITY CALCULATIONS

Labour productivity: Labour turnover calculation methods can be challenging due to the intangible nature of workers' outputs, especially in service providers like research, development, product creation, healthcare, and maintenance. Additionally, labour productivity is limited in highly automated businesses with large plant and machinery, and in industries like oil refining, chemical processing, and food processing. Furthermore, measuring labour productivity often overlooks the quality of work, as mistakes can negatively impact sales and output quality.

Labour turnover and retention: The method used above to calculate labour turnover may be limited. One reason is because of the difference in labour turnover between part-time and full-time workers. Labour turnover amongst part-time workers will be higher than that of full-time workers, even when doing the same job. This may be because many part-time workers are looking for a full-time job and will leave as soon as they get one. Alternatively, some part-time workers leave their part-time jobs regularly. One example might be students at the end of the college year. This means the labour turnover for businesses that have more part-time workers will be distorted.

Absenteeism rate: Absenteeism rates can be distorted by factors such as a small business's low rate due to long-term sickness or the way it is defined or recorded, affecting official calculations and affecting an employer's policy or culture.

STRATEGIES TO INCREASE PRODUCTIVITY AND RETENTION AND TO REDUCE TURNOVER AND ABSENTEEISM

If businesses can raise productivity and retention rates, and reduce staff turnover and absenteeism, the benefits will be significant. Here are a couple of reasons why.

- If productivity rises, output per employee will be higher so there is more output to sell. This will raise revenue and profit.
- If staff turnover can be reduced, money will be saved on recruitment, selection and training. This will help to cut costs and again increase profit. A number of human resources strategies might be used to help achieve these aims.

FINANCIAL REWARDS

Financial rewards can motivate employees to work harder and produce more. F.W. Taylor's theory of scientific management suggests that employees should be paid 'a fair day's pay for a fair day's work', focusing on productivity. This system rewards hard workers, reducing the earnings of slow or lazy workers, ultimately benefiting businesses and maximizing employee productivity.

Other ways of improving the performance of workers using financial rewards might be to adopt:

- performance-related pay
- bonus systems
- profit-related pay
- commission systems.

EMPLOYEE SHARE OWNERSHIP

Employee share schemes are a popular way for businesses to reward employees by offering company shares, often to senior managers and executives. These schemes involve employees saving their monthly pay for a fixed number of years, then using the saved money to buy shares at a fixed price. If the share price increases, employees can make a capital gain, while if it falls, they receive cash back.

CONSULTATION STRATEGIES

Three different types of **consultation** can be identified.

Pseudo-consultation: Pseudo-consultation is where management makes a decision and informs employees of that decision through their representatives. Employees have no power to influence these decisions. Some have suggested that it would be more accurately described as 'information giving'.

Classical consultation: Classical consultation is a way of involving employees, through their representatives, in discussions on matters which affect them. This allows employees to have an influence on management decisions.

Integrative consultation: Pseudo and classical consultation do not directly involve employees in decisions which affect them. Integrative consultation is a more democratic method of decision making. Some say it is neither consultation nor negotiation.

EMPOWERMENT STRATEGIES

Empowerment (i.e. giving somebody more power and control) involves making better use of the knowledge, experience and creative talents of employees. It is achieved by granting employees more authority in the workplace.

Training. It is not really possible to empower staff effectively without first preparing them with the skills needed to take on more advanced tasks. A business needs to identify any skills gap. This is the difference between an employee's current skills and those needed to complete new tasks. Training can help employees to learn new skills.

- Provide the necessary resources. To be empowered, staff need resources and information to complete more complex tasks.
- Hand over authority. Once employees have been empowered they must be confident that they have complete authority to make decisions.
- Inspire confidence. If employees are being empowered, it is important that they feel confident about their new role.
- Provide feedback. It is necessary to provide positive feedback to empowered workers at appropriate times. Workers need to know how they have performed in their new roles. Feedback will help to guide them in the future and build more confidence.

SUBJECT VOCABULARY

absenteeism where workers fail to turn up for work without good reason
capital gain the profit made from selling a share for more than it was bought for
consultation listening to the views of employees before making key decisions that affect them
labour productivity output per worker in a given time period
labour retention the number of employees who remain in a business over a period of time
labour turnover the rate at which staff leave a business
quality circles where workers are given time to meet regularly to discuss work issues such as solving problems
rate of absenteeism (absenteeism rate or absentee rate) the number of staff who are absent as a percentage of the total workforce. It can be calculated for different periods of time, e.g. daily or annually
sharesave scheme also known as a savings related share option scheme. Employees save some of their monthly pay for a fixed number of years. At the end of the period employees can use the money saved to buy shares at a price that was fixed at the outset, often at a discount