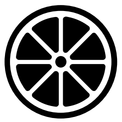
3.5.1 / 2 - Identifying & understanding customers & Segmentation

A **Market** consists of all the sales of one particular group of goods or services. For example, the grocery market, the housing market, or the stock market.

In every market, businesses must identify and satisfy customer needs. This is the purpose of **Marketing**. All businesses work hard to identify and satisfy customers needs in order to:

- Provide a product or service that customers will buy
- Select the correct **Marketing Mix**
- Avoid costly mistakes
- Be competitive and increase sales



The same way we would break up an orange, we **segment** a market.

Segmentation allows businesses to focus on individual groups, such as men/women, age groups, geographic location, levels of income.

By doing this, we can better understand the different groups of consumers we might be targeting. That way we can design products, pricing, advertising, and ways of delivering the product, that suit each group.

Benefits of accurate segmentation	Drawbacks of segmenting / risks of doing it badly
Businesses design better products, advertising, and prices, and promotions, which lead to more sales.	Detailed research will be required – this can be expensive
Understanding our customer better, we can predict what they may want in the future.	It can be very difficult to accurately predict what a customer will like or dislike
We can maximise the profit from each group – for example, knowing that some people have no choice but to use the train at a set time, means we could charge a higher price.	All of our competitors will be trying to do the same thing, meaning that if we don't do it well they will be able to gain a significant advantage over us.

3.5.3 - The purpose and methods of market research

Market Research is the process of a business collecting information that will help it to better compete with its opposition. It enables them to gain a better insight into their customers, and their wants and needs, and their competitors.

Purposes of Market Research – businesses collect information about:

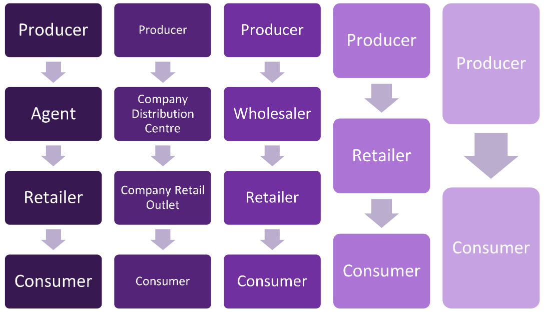
Demand	Competition	Target Market
How much/which products do consumers want/need? What features should their product have and what price should they set?	How are the competitors in the market operating? How are they different to us, and how are they innovating?	Who are our customers? What specific wants/needs to they have? Can we improve how we deal with them to increase sales?

Primary	Secondary	Quantitative	Qualitative
Research I design and conduct specifically for my business	Research someone else has designed and conducted	Data that is numerical / can be counted	Information that is descriptive and cannot be easily counted

Method	Advantages	Disadvantages
Questionnaires & Surveys	Easy / cheap to produce	Difficult to get responses May be leading questions
Interview	Detailed information as more time to ask further questions	Time consuming and so expensive
Focus Group	Opportunity for discussion More detailed responses	Time consuming Groups may not be representative
Internet Research & Printed Media	Lots of information available Cheap (Secondary Research)	Information can be misleading Others designed the research / may not be suited to your purpose

3.5.4 - The Marketing Mix: Place

Place refers to the different channels of distribution a business uses to get their products to the customers.



In each of the possible scenarios show above, the seller might choose a range of ways to sell to the buyer:

- Traditional – via a shop / office
- Modern retail – using technology to improve the process (i.e. self-scan/checkout)
- Telesales – sales made by phone direct to the customer
- E-commerce / M-Commerce – sales via a website or app

Choosing the right method of getting the product to the customer is vital.

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3.5.4 - The Marketing Mix: Promotion

Promotion is the name given to all of the business activities that encourage the customer to buy a product.

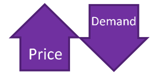
Why we promote	How we choose a method
It's important to promote a product, especially when it's new or if it is in a market where there's lots of competition. It's used to: - Inform/remind customers about the product - Create or increase sales - Create or change the image of the product - Persuade customers to buy or try the product	What a businesses chooses to do to promote their product is influenced by both internal and external factors: - Finance available to spend - What the competitors in the market are doing - The type of good or service the product is - The nature of the market and how competitive it is - Who the target market are

Advertising	PR	Sales Promotion	Sponsorship	Social Media
These are the types of adverts you would be familiar with on TV, Radio, in newspapers, on the internet and on billboards	Public Relations events and activities are the ones that change how we think about a business. For example, some give to charity.	Special offers and displays. 2 for 1 and BOGOF, free gifts, coupons, samples, competitions.	Businesses often sponsor football teams or sporting events. The same as they might sponsor a good cause such as a school.	Interacting with customers via social media is increasingly important to modern business. It involves the customer in the brand.

3.5.4 - The Marketing Mix: Price

Businesses set prices for their products based on a range of **internal** and **external** factors.

- Costs associated with the product
- Nature of the market
- Degree of competition in the market
- The stage a product is at in its lifecycle



Skimming	**Description:** Setting a higher price when a product is released **Potential Impact:** The company can try to take advantage of excitement around the release of the product – with customers willing to pay more to get the product sooner the company can recover some of its Research and Development costs
Penetration	**Description:** Setting a price lower than the competition for a short time **Potential Impact:** By pricing below the competition a company can attempt to increase their share of the market. If their product is new, or if they are entering this market for the first time, it could encourage customers to try the product or switch from a competing product.
Competitive	**Description:** Pricing alongside or similarly to the competition **Potential Impact:** By pricing alongside our rivals, customers will see our price as the "going-rate" – the normal price. We shouldn't be seen as expensive, and so customers are less likely to go elsewhere simply because of the price.
Loss Leader	**Description:** Setting a price for a product that means a loss is made on each sale **Potential Impact:** A very low price on a product may encourage people to visit the shop, and subsequently buy other items that do make a profit. An example of this is fuel at supermarkets. Their prices are lower in the hope that while filling up with fuel you will also shop in the store.
Cost-Plus	**Description:** Adding a percentage profit to the cost of producing/selling a product **Potential Impact:** Provided we sell enough units for us to cover our fixed costs, each unit we sell should make us a profit. We have set the price so that each sale covers its own variable costs.

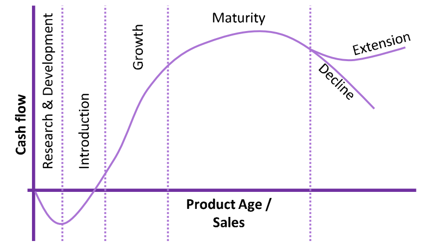
3.5.4 - The Marketing Mix: Product

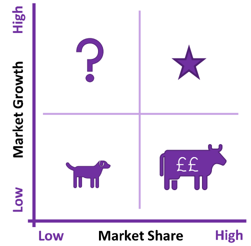
Deciding which products to offer is a marketing activity. There are risks and benefits of releasing new products and discontinuing old ones. Which products are sold and their quality, will affect **brand image**.

Having a **unique selling point** can improve sales in competitive markets.

The **Product Lifecycle** shows the stages that a product is likely to go through during its lifetime. The line shows how cashflow falls initially due to the high cost of R&D.

It also shows how decline is not inevitable, and that **extension strategies**, such as adding new features, could be used to maintain a products' popularity.





The **Boston Matrix** is a tool for analysing a business' **Product Portfolio**. This is the collection of products they offer.

Where a product appears in the matrix might help us to decide what to do next to improve our profitability.

Businesses often assume that spending money on marketing will help us to improve market share and move **dogs** to become **cash cows**, and **question marks** to become **rising stars**.

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Key Term	Definition
Advertising	Communicating with the customer to inform them about / convince them to buy a product
Boston Matrix	A tool that allows a business to analyse the value / prospects of each product in their portfolio.
Brand Image	How the brand is seen by the customer, their perception of its strengths, weaknesses, personality. It changes over time and all of the customers' interactions with the brand will inform it.
Competitive Pricing	Setting a price to be in line with a competitors' price for the same or similar products.
Complementary Product	A product that is sold alongside another that may be of use or interest to a customer. For example, extended warranties alongside the checkouts at Currys PCWorld.
Cost-Plus Pricing	Adding a percentage to the cost of producing a product so that a profit is made.
Customer Engagement	How the business tries to build a relationship with the customer in order to build loyalty.
Direct Marketing	Manufacturers speaking to customers without intermediaries. Often with leaflets or door-to-door salespeople.
Distribution Channels	How the product gets from manufacturer to the customer. Whose ownership does it pass through? Manufacturer > Wholesaler / Distributor / Agent > Retailer, etc.
EPOS	Electronic Point of Sale. A till / checkout that will automatically update stock / print coupons and vouchers etc.
Extension Strategies	Methods that extend the lifecycle of a product. Such as, updated packaging, adding new or different features, changing target market, special offers, advertising, and price reduction.
Focus Group	A group of people chosen from the target market to discuss a product. Provides the business with qualitative data relating to their opinions.
Intermediary	The businesses in the middle of the distribution channel between manufacturer and the customer.
Loss Leader	A product sold for less than it costs in order to encourage more customers. For example, fuel at supermarkets.
Market Research	Collecting information about customers, competitors, and the market that a company operates in.
Marketing	The activities within a business that combine to ensure the customer gets what they want, in the quantities they want, at a price they are willing to pay.
Marketing Mix	The four areas of marketing, and how a company uses them **in combination** to meet the needs and wants of customer while maximising sales, revenue and profit.

Key Term	Definition
Penetration Pricing	Setting a low price in order to establish a new product in a market, or to quickly gain market share.
Point of Sale	The place in a store, or webshop that the customer buys the product. Often an opportunity to attempt to sell complementary products.
PR – Public Relations	The act of managing the relationships between the business and wider groups. For example, environmental groups, pressure groups or investors. All with the aim of improving brand image.
Primary Research	Designing your own research, then collecting the information first-hand.
Product Differentiation	Developing features within a product that set it apart from other products in the same market. Using these differences to help promote the product and convince customers.
Product Lifecycle	The stages a product goes through from initial idea to removal. Research and Development > Introduction > Growth > Maturity > Decline (> Rejuvenation / Extension).
Product Portfolio	The range of products offered by a company.
Promotion	Communicating with customers in order to inform / remind them about a product or persuade them to buy.
Qualitative Market Research	Collecting information about customers' thoughts/opinions about a product – customers are able to explain in detail.
Quantitative Market Research	Collecting information in a numerical manner – less detail is possible, but statistical analysis is easier.
Retail	A business that sells goods.
Sales Value	The revenue generated from sales.
Sales Volume	The number of items sold.
Secondary Research	Using sources of information that have already been collected / published. Also called 'desk research.'
Segmentation	Dividing a market into groups that can be more easily targeted with specific products / adverts / prices. It enables the business to meet the needs of a specific group more easily.
Skimming	Setting a higher than usual price when a product is first released to capitalise on early adopters being willing to pay more. For example, Xbox 'Day One Edition.'
Telesales	Attempting to sell products by phone.
Unique Selling Point (USP)	The main benefit / key feature of a product that differentiates it from the other products in the same market.
Wholesaler	A business that sells in large quantities, usually buying them from manufacturers, then selling to retailers.

3.6.1 - Sources of finances

See over for the definitions of the following sources of finance.

Method	Benefits / Issues
Friends / Family	May not charge interest, or may let you repay over a more relaxed time-frame – but could harm relationships
Retained Profit	No interest and money is available instantly – but once it has been spent it is gone. Borrowing may be needed later.
Sale of Assets	Selling unwanted gods may result in the business getting back less than they paid.
Loan / Mortgage	Interest is charged on the loan – there is a rigid schedule for repayment. Reliable, interest rates are low.
Credit Card / Overdraft	Pre-arranged borrowing from a bank – can be spent like money – instant access – but typically high interest rates.
Sale and Leaseback	For items the business still needs, they can sell the building (e.g.) and then lease or rent it back from the new owner.
Trade Credit	Buy now-pay later. Enables business to obtain the resources they need, then are given x days to repay.
Hire Purchase	A deposit is paid, the business receives the goods and then is leant the remainder which they repay over time with interest.
Government Grants	Businesses can apply for grants that match things the government wants to encourage. i.e. small business start-up grants in areas of high unemployment.

Obtaining Finance:
Businesses use finance to pay for:

- Variable costs such as raw materials
- Overheads such as labour
- Land / Buildings / Capital Goods like machinery

It can be difficult to obtain finance, for this reason businesses create detailed business plans that can be used to convince lenders to give them **credit**.

Suitability of different methods:
Depending on the size, age and financial stability of a business, some methods may be more appropriate. **New businesses** might struggle to get loans from a bank, and so often owners will put their own money and money borrowed from family into the company. **Established businesses** who have a track record of making money and repaying debts will be more likely to borrow money.
Sometimes businesses only need to borrow **small amounts or for a short time**, meaning things like Credit cards, overdrafts, and Trade Credit become good choices.

Interest = cost of borrowing or the reward for saving

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3.6.3 - Financial terms and calculations

Businesses all aim to make a profit (for charities and NGOs this profit is usually in the form of a positive outcome for their cause). As a result we have to pay close attention to finances.

Profit = income is greater than expenditure
Loss = expenditure is greater than income

To calculate a businesses profit/loss we have to understand the relationship between costs and revenue. (see over for definitions of the terms below).

$$Profit\ or\ Loss = Revenue\ - Total\ Costs$$

$$Total\ Costs = Fixed + Variable\ Costs$$

Calculating Total Costs can catch people out – often you're given a single figure for Fixed Costs, but a **cost per unit** for Variable Costs. This means you need to calculate:

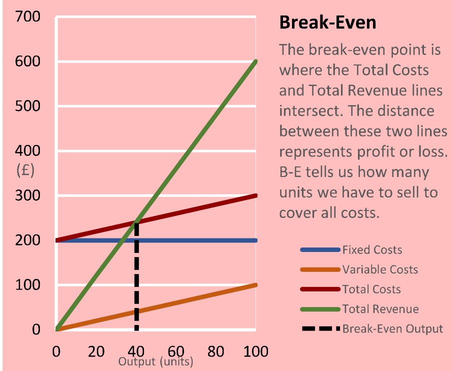
$$Total\ VCosts = Cost\ per\ unit\ \times the\ number\ of\ units$$

Margin of Safety
How many units are we making, above the break-even output. In the example, were the business making 60 units, the MoS would be 20 as the BEO is 40.

Average Rate of Return (ARR)
This is a method of investment appraisal. It looks at possible investment options and gives the % of the initial cost that will be returned as profit each year.

$$ARR\ (\%) = \frac{Average\ Profit\ per\ year}{Initial\ Cost}\ X\ 100$$

The investment option with the higher ARR % will most likely be chosen. However, other factors such as total profit, initial costs, and market conditions might also affect a company's choice.



Break-Even
The break-even point is where the Total Costs and Total Revenue lines intersect. The distance between these two lines represents profit or loss. B-E tells us how many units we have to sell to cover all costs.

3.6.2 - Cash flow

Cashflow is the term used to describe money entering and exiting a business. If cashflow is positive, then the business has the funds available to operate. If it is negative, they may not be able to pay their debts or be able to afford to buy stock etc.

Cash is king, and having enough cash available (either from sales or from borrowing) is vital. If a business has negative cashflow they will need to do something about it – possible solutions to cashflow problems include:

- **Re-scheduling payments** with creditors (people we owe money to) can allow extra time for more money to come in from sales

Thomas Cook went out of business in 2019, not because they didn't make profit – but because they didn't have sufficient cash to make their repayments on their debts. Their creditors refused to extend deadlines. Unable to find alternative sources of credit – they defaulted on their loans and were forced to declare bankruptcy.

- **Cutting costs** will reduce cash outflows and improve net cashflow as long as it doesn't harm our ability to generate sales
- **Increasing sales** will increase our inflows – but could cost us money (on marketing) in order to do it
- **New sources of finance** could make up the cash shortfall

Cashflow Forecast
Businesses need to predict whether they are likely to have any cashflow problems in the near future, as they may need to put finance in place to cover any deficit between income and expenditure.

In the example below, we can see that this business is predicting **positive net cashflow in January** – they will spend less than they earn. Whereas in February and March they expect **negative cashflow**, they will spend more than they earn. By the end of March they will have a negative bank balance. They will need some finance, possibly from their bank agreeing an Overdraft.

	January	February	March
Opening Balance	50,000	60,000	50,000
Cash in-flows	100,000	70,000	10,000
Cash out-flows	90,000	80,000	70,000
Net cash flow	10,000	(10,000)	(60,000)
Closing balance	60,000	50,000	(10,000)

3.6.4 - Analysing the financial performance of a business

Income Statement
This document shows the profit or loss of a business. (see over for descriptions)

Item	2018 (£m)	
Revenue	300	Money from Sales
Cost of Sales	100	Variable Costs
Gross Profit	**200**	300-100 = 200
Overheads	50	Fixed Costs
Operating Profit	**150**	200-50 = 150
Tax and interest	25	
Net Profit	**125**	150-25 = 120

Statement of Financial Position
This document shows the assets and liabilities of a business.

Assets are things the business owns
Liabilities are the debts of the business
Current means an asset or liability we will have for less than a year, **non-current/fixed** for more than a year.

Balance Sheet	£m	
Fixed Assets	**400**	Buildings etc.
Current Assets		These are things we will own for less than one year. **Debtors** is the money still owed to us by our customers. We own their debt, therefore this is an Asset.
Stock	174	
Debtors	109	
Bank and Cash	17	
Total Current Assets	**200**	
Current Liabilities	**(100)**	Payments we need to make this year
Net Current Assets	**100**	Current assets – current liabilities
Net Assets Employed	**500**	Fixed + Net Current Assets
Non Current Liabilities	**195**	Long-term debts
Net Assets	**305**	All assets – all liabilities
Equity / Reserves		This is the money that has been invested by shareholders (Capital) and the money we have reinvested from past years (Reserves)
Capital (Equity)	125	
Reserves	180	
Total Equity	**305**	

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Key Term	Definition
Asset	Something owned by a business.
Average rate of return	The average amount of profit made from an investment, as a percentage of the initial cost. $ARR\ (\%) = \frac{Average\ Profit\ per\ year}{Initial\ Cost}\ X\ 100$
Break-even Chart	A graph showing costs and revenue, and the point where they cross is the break-even point, this shows the output required to break-even.
Break-even Output	How many units must be sold in order to break-even. At this point, total costs and total revenue are the same.
Cash	Money that the business has in cash or in the bank available to spend.
Cash flow	The money moving into and out of the business.
Cash flow forecast	A prediction of how much money will flow into and out of the business. It is a planning tool.
Cash Inflow	Money coming into the business.
Cash Outflow	Money going out of the business.
Closing Balance	How much money still in the bank account at the end of a month / year.
External Sources of Finance	Getting money from business, people, or other organisations outside the business. For example, loans from banks, selling shares to private investors, subsidies from the Government.
Fixed Costs	Costs that do not change when our output changes. For example, rent.
Government Grants	Money given to businesses by the Government in exchange for them operating in a particular place or way. They must be applied for.
Gross Profit / GP Margin	$Gross\ Profit = Total\ Revenue - Costs\ of\ Sales$ $Gross\ Profit\ Margin\ (\%) = \frac{Gross\ Profit}{Revenue}\ X\ 100$
Hire Purchase	Buying items by making an initial payment, then paying the remaining money owed over a longer period of time.
Income Statement	A document that summarises the money moving into and out of the business. Showing whether a profit or loss is being made.
Interest Rates	The reward for saving, the cost of borrowing. A percentage added to the balance (of the savings or loan) for a given period of time – such as each month.

Key Term	Definition
Internal sources of finance	Funding the business using the owners' own money, by selling assets belonging to the business, or by making use of Sale & Leaseback.
Liability	The responsibility for debts of a business. If a business takes out a loan, it becomes a liability – the business is responsible for repaying.
Loans / Mortgages	An amount of money borrowed for a period of time, with an agreed rate of interest and deadline, repaid in instalments. Mortgages are a special type of loan, for more money paid back over a longer time in order to buy property.
Loss	Expenditure is greater than income.
Margin of Safety	How many more sales are being made than necessary to break-even.
Net Cash flow	The difference between cash inflows and outflows. $Net\ Cash\ flow = Cash\ Inflows - Cash\ Outflows$
Net Profit	$Net\ Profit = Operating\ Profit - Tax\ \&\ Finance\ costs$
Opening Balance	How much money is in the account at the beginning of a month or year.
Operating Profit / OP Margin	$Operating\ Profit = Gross\ Profit - Overheads$ $Operating\ Profit\ Margin\ (\%) = \frac{Operating\ Profit}{Revenue}\ X\ 100$
Overdraft	Agreed amount that can be spent when the balance of a bank account if £0, this allows the balance to be negative.
Profit	Income is greater than expenditure.
Profit Margin	What percentage of revenue is being kept by the business after different costs have been paid.
Profit Maximisation	Setting out to make the most profit possible, even if it means not achieving, or having to put on hold, other goals.
Raising Finance	Getting the money to invest in machinery etc. to start or grow a business.
Retained Profit	Profit from previous years that has been kept for future projects. This is an internal source of finance.
Revenue	Income from sales.
Sale & Leaseback	A business sells an asset and then leases it back from the new owners. An internal source of finance that allows a business to release money tied up in buildings or expensive equipment.
Share issue	The business is divided into more shares, the new shares are made available for the public to buy, and the business receives the money. An external source of finance.
Statement of Financial Position or Balance Sheet	Also called a Balance Sheet – a document that summarises the assets, liabilities, and equity of a business.
Total Costs	All costs a business must pay in order to operate.
Variable Costs	Costs that change depending on the level of production. For example, when more units are produced, more raw materials are consumed.