Citrus Business Management Programme

Module 8

Manage Your Business: Sales and Marketing

Learner Guide

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Contents

Directions

Unit Standard Information

Demonstrate an understanding of the function of the market mechanisms in a new venture

SAQA US ID	**UNIT STANDARD TITLE**			
263514	Demonstrate an understanding of the function of the market mechanisms in a new venture			
ORIGINATOR				
Task Team - New Venture Creation				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 03 - Business, Commerce and Management Studies			Generic Management	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular	Level 4	NQF Level 04	5
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
Reregistered		2015-07-01	2018-06-30	SAQA 10105/14
LAST DATE FOR ENROLMENT		**LAST DATE FOR ACHIEVEMENT**		
2019-06-30		2022-06-30		

In all of the tables in this document, both the pre-2009 NQF Level and the NQF Level is shown. In the text (purpose statements, qualification rules, etc), any references to NQF Levels are to the pre-2009 levels unless specifically stated otherwise.

This unit standard replaces:

US ID	Unit Standard Title	Pre-2009 NQF Level	NQF Level	Credits	Replacement Status
114595	Demonstrate an understanding of the function of the market mechanisms in a new venture	Level 4	NQF Level 04	5	Complete

PURPOSE OF THE UNIT STANDARD

This Unit Standard is intended for learners who wish to develop an understanding of the way market mechanisms operate in a new venture. It will also address the economic realities of South Africa and the role new ventures play in job creation.

Learners credited with this unit standard will be able to:

- Explain the free market system in terms of perfect and imperfect competitive markets.
- Analyse the interaction of demand and supply in price determination.
- Analyse the factors that influence economic activity.
- Describe the development and significance of markets.

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

It is assumed that the learner has the following knowledge and skills:

- Communication at NQF Level 3.

UNIT STANDARD RANGE

N/A

Administer contracts for a selected new venture

SAQA US ID	**UNIT STANDARD TITLE**			
119671	Administer contracts for a selected new venture			
ORIGINATOR				
SGB Generic Management				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 03 - Business, Commerce and Management Studies			Generic Management	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular-Fundamental	Level 3	NQF Level 03	10
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
Reregistered		2015-07-01	2018-06-30	SAQA 10105/14
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In all of the tables in this document, both the pre-2009 NQF Level and the NQF Level is shown. In the text (purpose statements, qualification rules, etc), any references to NQF Levels are to the pre-2009 levels unless specifically stated otherwise.

This unit standard does not replace any other unit standard and is not replaced by any other unit standard.

PURPOSE OF THE UNIT STANDARD

Learners working towards this standard will be learning towards the full qualification, or will be working within a SMME (Small, Medium, Micro Enterprise) environment, specialising in New Venture Ownership and Management, where the acquisition of competence against this standard will add value to one's job. This standard will also add value to entrepreneurs who are seeking to develop their entrepreneurial skills so that they can become more marketable for bigger contracts, including commercial and public sector contracts, for example the Department of Public Works programmes.

The qualifying learner is capable of:

- Obtaining contract and analyse performance requirements
- Applying basic risk management techniques in managing performance
- Demonstrating an understanding of contract changes and disputes
- Ensuring compliance and administrative close-out of contract

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

All learners accessing this qualification must be in possession of a GETC or equivalent qualification. The learner must be competent in communications and mathematical literacy at NQF level 2.

UNIT STANDARD RANGE

N/A

Using the Learner Guide

This learning material has been developed to assist the learner wishing to complete this unit standard. The guide contains all necessary learning to ensure that the learner will attain the competencies required by the unit standard.

The learner guide is accompanied by formative and summative portfolio of evidence (PoE) guides. Please ensure that you have access to these guides as well. The learner guide was designed to be used by a learner during the presentation of a skills programme based on the unit standard and to be kept afterwards by the learner for reference purposes. The PoE guides were designed to be completed during and after the presentation of the skills programme and forms part of the assessment process.

Background Information

The main theme of this module is marketing. It centres on understanding the concept of market forces and contractual agreements when making marketing decisions. Note that this module has been contextualised for agribusiness.

The module will cover aspects such as:

- The free market system in terms of perfect and imperfect competitive markets.
- The interaction of demand and supply in price determination, under perfectly competitive market conditions.
- The factors that influence economic activity.
- The development and significance of markets (with relevance to South Africa).
- Contract administration principles and techniques.
- Basic risk management techniques in managing performance.
- Handling contract changes and disputes.
- Compliance and administrative close-out of contract.

This module contributes to the exit level outcome and associated criteria:

4. Manage a new venture by applying business principles and techniques.
   - 4.1. A business plan for a new venture is developed using strategic planning principles and techniques.
   - 4.2. Guidelines for the implementation and monitoring the strategic action plan are formulated in terms of milestones and timeframes.
   - 4.3. Financial management planning principles and techniques are applied in order manage the business in an efficient and effective manner.
   - 4.4. Production and / or operations management is applied in a chosen business opportunity.
   - 4.5. Sound human resources management techniques are applied in order to set up a productive and motivated workforce for a business.
   - 4.6. Administrative principles and procedures are applied for sound administration and record-keeping.

This module comprises of 2 unit standards and attracts 15 credits.

This module is aligned to unit standards:

Section 1	**Marketing and Market Forces**	263514	Demonstrate an understanding of the function of the market mechanisms in a new venture	C	4	5
Section 2	**Contractual Agreements**	119671	Administer contracts for a selected new venture	C	3	10

Learning Outcomes

This learner guide has the following learning outcomes:

Section 1 – Marketing and Market Forces

1. Explain the free market system in terms of perfect and imperfect competitive markets.
    1.1. Give an explanation of the characteristics of different economic systems.
    1.2. Explain the role of competition in a free market system and give examples from state-owned business and the private sector.
    1.3. Illustrate competition by listing prices for the same product or service.
    1.4. Describe and give examples of reasons for imperfect competitiveness.
    1.5. Explain and give examples of the advantages and disadvantages of competition.
    1.6. Give a description of the interaction of role-players in the economic system.
    1.7. Explain the conditions for the existence of perfect and imperfect markets in the South African context.
2. Analyse the interaction of demand and supply in price determination, under perfectly competitive market conditions.
    2.1. Explain the laws of demand and supply.
    2.2. Explain the consequences of the law of demand and supply for new ventures.
    2.3. Explain the relationship between variables of demand and supply curves.
    2.4. Discuss the relationship between demand, supply and price in terms of agricultural produce.
    2.5. List factors that lead to changes in demand and supply curves for agricultural produce.
    2.6. Explain factors of production in terms of roles and contribution to the economy.
    2.7. Explain the role that money plays in terms of the economy.
3. Analyse the factors that influence economic activity
    3.1. Evaluate the effects of cyclical movements in the market system on a citrus production unit.
    3.2. Describe the concept of inflation and how it impacts new agribusinesses.
    3.3. Identify reasons for the decline in the value of money.
    3.4. Explain the role of foreign currency and exchange rates in the general economy.
    3.5. Explain the role of interest rates, gross domestic product and balance of payments in operations of an agribusiness.
4. Describe the development and significance of markets (with relevance to South Africa).

4.1. Investigate international trade as a result of uneven resource distribution with reference to opportunities for a new agribusiness.

4.2. Identify socio-economic factors that underline the importance of new business development in South Africa.

4.3. Identify and classify existing growth sectors in South Africa and explain how it may influence new agribusiness ventures.

Section 2 – Contractual Agreements

1. Understand and explain contract administration principles and techniques.

   1.1. Obtain and analyse performance requirement of contract.

   1.2. Obtain and interpret a contract document in agribusiness.

   1.3. Analyse a contract document and draw up a basic contract administration plan to ensure effective contracts management.

   1.4. Evaluate the risks of non-compliance against performance requirements of the business.

   1.5. Draw up a basic risk management plan to avoid non-compliance problems.

2. Apply basic risk management techniques in managing performance.

   2.1. Implement the risk management plan related to the contract in line with the contractual requirements.

   2.2. Identify and quantify common risk areas against the contract performance requirements and the original risk management plan.

   2.3. Obtain contract progress reports and measure them against the performance requirements and the risk management plan.

   2.4. Conduct surveillance of risk areas and take appropriate corrective action to avoid negative risk.

3. Demonstrate an understanding of contract changes and disputes.

   3.1. Identify and understand contract terms and conditions related to changes and disputes in order to manage the contract effectively.

   3.2. Implement change and dispute processes where relevant.

   3.3. Negotiate and document changes and disputes in order to proactively address potential areas of dispute.

   3.4. Seek external advice where necessary in order to resolve disputes and ensure that negative business risk is avoided.

4. Ensure compliance and administrative close-out of contract.

   4.1. Evaluate work and performance results against contract deliverables and establish whether work is completed effectively.

   4.2. Understand and implement terms related to contract termination according to contractual requirements.

   4.3. Conduct a basic audit to ensure that all parties have complied with their contractual obligations.

   4.4. Sign off and finalise administrative procedures to ensure closure of the contract.

Note that the following critical outcomes are also developed and assessed in an integrated manner, as part of this learning module:

1. Collecting
2. Communicating
3. Demonstrating
4. Identifying
5. Organising
6. Science
7. Working

Keep these learning goals in mind throughout your work related to this module.

There is an opportunity for self-assessment and a progress check at the end of this learner guide. Make time to assess yourself and ask the facilitator, assessor, your workplace mentor or coach for help if you are unsure of the answers.

Section 1: Marketing and Market Forces

Learning Goals and Pathways

In order to start operating a business effectively, you have to make some key sales and marketing decisions. In order to make these decisions wisely, you need to understand the basics of marketing and market forces.

This section will help you to examine and understand some of the concepts and considerations that influence marketing decisions.

This section is presented in chapters 1 to 4 of the guide.

The learning goals for this module include:

1. Explain the free market system in terms of perfect and imperfect competitive markets.
2. Analyse the interaction of demand and supply in price determination, under perfectly competitive market conditions.
3. Analyse the factors that influence economic activity.
4. Describe the development and significance of markets (with relevance to South Africa).

Chapter 1
The Free Market System: Perfect and Imperfect Markets

Different Economic Systems

Economics is the study of the economic problems and variables of the community as a whole, with the improved well-being of the community as its preconceived goal.

definition

Economics

The term economics can be defined as:

The study of how humans use the limited resources at their disposal in order to satisfy as many of their endless needs and desires as possible. Thus, economics is the study of man's behaviour in acquiring and utilising the limited factors of production in order to maximise utility.

The world's economic systems fall into one of four main categories: traditional economy, market economy, command economy and mixed economy. There are unlimited variations of each type. An economic system must define what to produce, how to produce it and for whom to produce it.

Traditional Economic System

A traditional economic system is the best place to start because it is, quite literally, the most traditional and ancient type of economy in the world. There are certain elements of a traditional economy that those in more advanced economies (such as mixed economies) would like to see return to prominence.

- Where tradition is cherished: Traditional economies still produce products and services that are a direct result of their beliefs, customs, traditions and religions. Vast portions of the world still function under a traditional economic system. These areas tend to be rural, second- or third-world and closely tied to the land, usually through farming. However, there is an increasingly small population of nomadic peoples, and while their economies are certainly traditional, they often interact with other economies in order to sell, trade and barter. The geography of globalisation refers to the complexities of globalisation and how it shapes economic relationships and affects cultures.
- Minimal waste: Traditional economies would never, ever, in a million years see the type of profit or surplus that results from a market or mixed economy. In general, surplus is a rare thing. A third-world and / or indigenous country does not have the resources necessary (or if they do, they are controlled by wealthier economies, often by force), and in many cases, any surplus is either distributed, wasted or paid to some authority that has been given power.

- Advantages and disadvantages: Certainly one of the most obvious advantages is that tradition and custom is preserved while it is virtually non-existent in market / mixed economies. There is also the fact that each member of a traditional economy has a more specific and pronounced role, and these societies are often very close-knit and socially satisfied. The main disadvantage is that traditional economies do not enjoy the things other economies take for granted such as western medicine, centralised utilities and technology. But as anyone in America can attest, these things do not guarantee happiness, peace, social or, most ironically of all, economic stability.

Command Economic System

In terms of economic advancement, the command economic system is the next step up from a traditional economy. This by no means indicates that it is fairer or an exact improvement. There are many things fundamentally wrong with a command economy.

- Centralised control: The most notable feature of a command economy is that a large part of the economic system is controlled by a centralised power; often, a federal government. This kind of economy tends to develop when a country finds itself in possession of a very large amount of valuable resource(s). The government then steps in and regulates the resource(s). Often the government will own everything involved in the industrial process, from the equipment to the facilities.
- Dangers: Interestingly – or maybe, predictably – the government in a command economy only desires to control its most valuable resources. Other things, like agriculture, are left to be regulated and run by the people. This is the nature of a command economy and many communist governments fall into this category.
- Advantages: You can see how this kind of economy would, over time, create unrest among the general population. But there are actually several potential advantages, as long as the government uses intelligent regulations. First of all, a command economy is capable of creating a healthy supply of its own resources and it generally rewards its own people with affordable prices. Because it is ultimately regulated by the government, it is ultimately priced by the government. Still, there is often no shortage of jobs as the government functions similarly to a market economy in that it wants to grow and grow upon its populace.

Market Economic System

A market economy is very similar to a free market. The government does not control vital resources, valuable goods or any other major segment of the economy. In this way, organisations run by the people determine how the economy runs, how supply is generated and what demands are necessary.

- Capitalism and socialism: No truly free market economy exists in the world. For example, while South Africa is a capitalist nation, our government still regulates (or attempts to regulate) fair trade, government programs, business and monopolies. The advantage to capitalism is you can have an explosive economy that is very well controlled and relatively safe. This can be contrasted to socialism, in which the government (like a command economy) controls and owns the most profitable and vital industries but allows the rest of the market to operate freely. In other words, the price is allowed to fluctuate freely based on supply and demand.

- Market economy and politics: Arguably the biggest advantage to a market economy (at least, outside of economic benefits) is the separation of the market and the government. This prevents the government from becoming too powerful, too controlling and too similar to the governments of the world that oppress their people while living lavishly on controlled resources. In the same way that separation of church and state has been so vital to America's social success, so has a separation of market and state been vital to our economic success. Yes, there is something wary about a system which to be successful must foster constant growth, but as a result, progress and innovation have occurred at such incredible rates as to affect the way the world economy functions.

Mixed Economic System

A mixed economic system (also known as a dual economy) is just like it sounds: a combination of economic systems. It primarily refers to a mixture of a market and command economy. For obvious reasons, a traditional economy does not typically mix well. As you can imagine, many variations exist, with some mixed economies being primarily free markets and others being strongly controlled by the government

Benefits of a mixed economy: In the most common types of mixed economies, the market is more or less free of government ownership except for a few key areas. These areas are usually not the resources that a command economy controls. Instead, as in South Africa, they are the government programs such as education, transportation and electrical supply.

Disadvantages of a mixed economy: While a mixed economy can lead to incredible results (South Africa being the obvious example), it can also suffer from similar downfalls found in other economies. For example, the last twenty years has seen a rise in government power, but with a lack of planning and foresight to develop infrastructure and maintain systems in its existing parastatal enterprises.

Economic System of Business in South Africa

The business world is a system of individuals and organisations, which, in a market economy, produces foods and services to meet people's needs. The single most important characteristic of the business world as it is seen in the so-called First World or the developed countries of the West and Asia, is the freedom of individuals to start or close a business enterprise, to buy and sell shares in businesses and to produce (within limits) any product or service the market requires.

This system, in which individuals themselves decide what to produce, how to produce it and what price to sell their products, is called a free-market system or a market economy. It is an economy in which the prices of goods and services are determined in a free price system set by supply and demand. This system is followed in the South African economy.

It is a complex system comprising various types of small and large business organisations that mobilise the resources of the country to satisfy the needs of its inhabitants.

Each and every individual within a country's economy forms part of and is affected by, the economy. Everybody uses money, acts as a consumer and relies on the receipt of income to finance purchases. As changes occur in the economy so each individual is affected, but the collective activities of individuals may result in changes in the economy of the country.

Issues such as taxation, price setting by the state and levels of unemployment affect us all. For the producer trade unions, costs of imported machinery and nationalisation are important considerations. These factors affect us all by influencing the cost of every product we consume as well as every other aspect of our daily lives.

Economic decisions we make in our private and business lives do not affect our lives alone, but that of many others.

definition

Free market

A free market can be defined as:

A market without economic intervention and regulation by government except to outlaw and prosecute force or fraud. It is the opposite of a controlled market, where the government regulates how the means of production, goods, and services are used, priced, or distributed. A free market economy is an economy where all markets within it are free. This requires protection of property rights, but no regulation, no subsidisation, no government-imposed monopolistic monetary system, and no governmental monopolies.

The theory holds that within the ideal free market, property rights are voluntarily exchanged at a price arranged solely by the mutual consent of sellers and buyers. By definition, buyers and sellers do not coerce each other, in the sense that they obtain each other's property rights without the use of physical force, threat of physical force, or fraud, nor are they coerced by a third party (such as by government via transfer payments) and they engage in trade simply because they both consent and believe that what they are getting is worth more than or as much as what they give up. Price is the result of buying and selling decisions collectively, as described by the theory of supply and demand (more about this later).

Free markets contrast sharply with controlled markets or regulated markets, in which governments directly or indirectly regulate prices or supplies, which according to free market theory causes markets to be less efficient. Where government intervention exists, the market is a mixed economy.

Capitalism generally refers to an economic system in which the means of production are all or mostly privately owned and operated for profit, and in which investments, distribution, income, and pricing of goods and services are determined through the operation of a market economy. It is usually considered to involve the right of individuals and groups of individuals acting as "legal persons" or corporations to trade capital goods, labour, land and money.

Capitalism has been dominant in the Western world since the end of feudalism, but most feel that the term "mixed economies" more precisely describes most contemporary economies, due to their containing both private-owned and state-owned enterprises, combining elements of capitalism and socialism, or mixing the characteristics of market economies and planned economies. In capitalism, there is no central planning authority but the prices are decided by the demand-supply scale. For example, higher demand for certain goods and services lead to higher prices, and lower demand for certain goods lead to lower prices.

Competition in a Free Market System

Competition in economics is a term that encompasses the notion of individuals and firms striving for a greater share of a market to sell or buy goods and services. Competition in business can be defined as "the effort of two or more parties acting independently to secure the business of a third party by offering the most favourable terms." Competition causes commercial firms to develop new products, services and technologies, which would give consumers greater selection and better products. The greater selection typically causes lower prices for the products, compared to what the price would be if there was no competition (monopoly) or little competition (oligopoly).

Competition is seen as a state which produces gains for the whole economy, through promoting consumer sovereignty. It may also lead to wasted (duplicated) effort and to increased costs (and prices) in some circumstances. In a small number of goods and services, the cost structure means that competition may be inefficient. These situations are known as natural monopoly and are usually publicly provided or tightly regulated. The most common example is water supplies.

Three Levels of Economic Competition

1. The most narrow form is direct competition (also called category competition or brand competition), where products that perform the same function compete against each other. For example, a brand of minibuses competes with several different brands of minibuses. Sometimes two companies are rivals and one adds new products to their line so that each company distributes the same thing and they compete.
2. The next form is substitute competition, where products that are close substitutes for one another compete. For example, butter competes with margarine, mayonnaise, and other various sauces and spreads.
3. The broadest form of competition is typically called budget competition. Included in this category is anything that the consumer might want to spend their available money (the so-called discretionary income) on. For example, a family that has R 20,000-00 available may choose to spend it on many different items, which can all be seen as competing with each other for the family's available money.

   Business and economic competition in most countries is often limited or restricted. Competition often is subject to legal restrictions. For example, competition may be legally prohibited as in the case with a government monopoly or a government-granted monopoly. Tariffs, subsidies or other protectionist measures may also be instituted by the government in order to prevent or reduce competition. Depending on the respective economic policy, the pure competition is to a greater or lesser extent regulated by competition policy and competition law.

   Competition between countries is quite subtle to detect but is quite evident in the World economy, where countries like the US, Japan, the European Union, China and the East Asian Tigers each try to outdo the other in the quest for economic supremacy in the global market.

   Such competition is evident by the policies undertaken by these countries to educate the future workforce. For example, East Asian economies like Singapore, Japan and South Korea tend to emphasise education by allocating a large portion of the budget to this sector, and by implementing programmes such as gifted education, which some detractors criticise as indicative of academic elitism.

Perfect Competition

In economics, perfect competition occurs in markets in which no participant has market power. Because the conditions for perfect competition are strict, there are few if any perfectly competitive markets. Nonetheless, the concept of perfect competition can serve as a useful benchmark against which to measure real life, imperfectly competitive markets.

Generally, a perfectly competitive market exists when every participant is a "price taker," and no participant influences the price of the product it buys or sells. Specific characteristics may include:

- Infinite buyers / infinite sellers – Infinite consumers with the willingness and ability to buy the product at a certain price. Infinite producers with the willingness and ability to supply the product at a certain price.
- Zero entry / exit barriers – It is relatively easy to enter or exit as a business in a perfectly competitive market.
- Perfect information - Prices and quality of products are assumed to be known to all consumers and producers.
- Transactions are costless - Buyers and sellers incur no costs in making an exchange (perfect mobility).
- Firms aim to maximise profits - Firms aim to sell where marginal costs meet marginal revenue, where they generate the most profit.
- Homogeneous products – The characteristics of any given market product or service do not vary across suppliers.
- The absence of collusion.

Perfect competition can arise where there is an inability of any one agent to affect prices.

information

Profit in perfect competition

It is impossible for a firm in perfect competition to earn economic profit in the long run, which is to say that a firm cannot make any more money than is necessary to cover its economic costs.

The reason is that if a firm is earning an abnormal profit in the short term, this will act as a trigger for other firms to enter the market. They will compete with the first firm, driving the market price down until all firms are earning normal profit only.

If there was perfect competition:

One would assume that all sellers are passive. In other words, they do not try and increase their profits by, for example:

- Undercutting prices
- Improved product design
- Advertising
- Innovation

- There would be no market power:
  - No advertising
  - No control over resources
  - No proprietary technology
  - No patents
  - No trademarks
  - No copyrights
  - No geographical advantages
  - No customer loyalty
  - No branding or marketing
  - No government regulation
  - No collusion
  - No labour contracts or trade unions
  - No research and development costs
  - No sunk costs
  - No stocks of inputs
  - No distribution networks
  - No middle-men
  - No economies of scale

This is obviously not the reality!

Imperfect Competition

In economic theory, imperfect competition is the competitive situation in any market where the conditions necessary for perfect competition are not satisfied. It is a market structure that does not meet the conditions of perfect competition. Forms of imperfect competition include:

- Monopoly, in which there is only one seller of a product
- Oligopoly, in which there is a small number of sellers
- Monopolistic competition, in which there are many sellers producing highly differentiated goods
- Monopsony, in which there is only one buyer of goods
- Oligopsony, in which there is a small number of buyers
- Information asymmetry, when one competitor has the advantage of more or better information

There may also be imperfect competition due to a time lag in a market. An example is the "jobless recovery". There are many growth opportunities available after a recession, but it takes time for employers to react, leading to high unemployment. High unemployment decreases wages, which makes hiring more attractive, but it takes time for new jobs to be created.

Why Do Prices Differ?

In module 3 of this learning programme, we looked at the different factors that growers consider when deciding on the pricing of their produce.

But in an ideal world, surely most products of the same quality offered to the same customers from different suppliers, should have the same price.

Let us explore marketing ideas around bringing new products or produce to market which may impact price points.

Developing new products is a common feature of running a business. Companies that develop new goods or services often meet a specific market niche in the economic marketplace. Businesses must find the best way to market these products and price them at a point where consumers are comfortable purchasing the product.

Several pricing strategies exist when introducing new products in the economic marketplace. Although these strategies often depend on current market conditions, they can offer specific guidelines for pricing goods or services.

Penetration Pricing

Penetration pricing sets product prices low for a specific time period to gain market share and lure consumers away from current competitors. This is a common strategy when introducing new products into the current economic marketplace. Once companies develop a strong client base, they often raise product prices to the normal level.

Economy Pricing

Economy pricing usually represents the lowest price a company can charge for goods or services. The economy pricing strategy can help undercut current price levels of your competitors by offering a similar product with no frills or fancy features.

Companies do not usually spend a lot of money on administrative features, such as marketing or branding strategies when using economy pricing.

Price Skimming

Price skimming allows companies to charge a higher price for specific goods or services based on the company's competitive advantage. Because the company expects competitors to flood the market with similar products, the price skimming strategy requires companies to reduce their product prices to compete with competitor products.

Bundle Pricing

Companies can use bundle pricing by attaching new products with a current product or service at a specific price point. Bundle pricing usually includes a slight discount over buying these items separately. Companies use this strategy to help provide additional value for a specific product.

This strategy is also useful if the new product requires consumers to purchase additional items relating to the new product.

Promotional Pricing

Promotional pricing usually involves companies creating various marketing strategies to inform consumers about the new product. Promotional pricing may include a buy-one-get-one-free offer, discounted initial price or free items given to consumers who purchase the first 100 products. Promotional pricing may also drive sales of other products if companies require consumers to visit retail locations to benefit from promotions.

Captive Pricing

Captive pricing is a strategy where companies offer new products at lower prices but consumers may be required to purchase additional items down the road relating to the product. A classic example of this strategy is shaving razors. Although purchasing a new razor may be relatively inexpensive, manufacturers make up the income difference by charging higher prices for replacement blades.

Advantages and Disadvantages of Competition

In most economic markets, competition determines how industries operate. Competition among companies is what gives consumers choice, allowing them to select products that fit their budget and needs. Thus, economic competition provides great advantages, but it also comes at a cost. For example, some industries have such a high barrier, or high cost, to enter that one or two key companies control the market.

Primary Advantages

Along with the advantage already listed (i.e. choice), economic competition forces companies and countries to increase their efficiency and continually seek ways to improve their production process for maximum efficacy. New business problems and consumer problems are created every day, providing opportunities for companies to innovate new products that solve these problems. Healthy economic competition, when free of monopolies, can also attract investments from other countries, thereby increasing a nation's gross domestic product. A final key advantage of economic competition is that it allows anyone with a specialised skill set to create something better than what the market currently offers and clean up. Many of the large brands with which we are familiar today were started by a small team dedicated to solving a customer pain point.

Primary Disadvantages

Unfortunately, economic competition comes with significant disadvantages. Foremost, investment wealth can be disproportionately allocated into what earns the highest profit, leaving less money for social services, such as police departments, public schools and emergency aid. Countries that outsource their production to companies overseas may partner with suppliers who provide poor working conditions and low wages, exploiting workers and offering inadequate incentives. Some politically minded economists would also argue that a key disadvantage of economic competition is that it reduces the amount of human labour required to produce goods, as machinery replaces assembly jobs once filled by human workers.

Characteristics of Competitive Economies

Competitive economies, more commonly known as market economies, have several defining characteristics. No matter what the circumstances, consumers will find the financial means necessary to purchase products they feel they need. Once they have met these needs, more competitive forces will emerge. Consumers will then spend their surplus money on wants, thus reinforcing social class divisions based on the possession of material items.

Balancing Advantages and Disadvantages

Striking a balance between the advantages and disadvantages of a competitive economy is important because it prevents economic collapse. While these advantages and disadvantages change constantly due to a multitude of market factors and global currency values, the market economy is self-regulating in the sense that when consumers experience too many of its disadvantages, they will shift their attention and spending habits toward, as well as supporting legislation conducive to, its advantages.

Interaction of Role-players

No economic system can function if there is no interaction between role-players. In fact, an economic system is the structure of production, allocation of economic inputs, distribution of economic outputs, and consumption of goods and services in an economy and these are defined by a set of institutions (legal entities, individuals) and their social relations.

Thus, most importantly, an economic system is composed of people and institutions, including their relationships to productive resources, such as through the convention of property (rights) and other laws governing their interactions.

An economic system refers to the organisational arrangements and processes through which a society makes its production and consumption decisions. In creating and modifying its economic system, each society chooses among alternative objectives and alternative decision modes. Many objectives may be seen as desirable, like efficiency, growth, liberty, and equality.

practical

Complete the following formative assessment:

F263514.1 – Team Discussion, Series of Research Posters and Class Presentations with Key Notes

Chapter 2
Supply, Demand and Price Determination

Laws of Demand and Supply

When the government is not involved in the setting of prices, prices are determined by means of the supply and demand mechanism – also known as the free market or market economy. For a certain group of products such as petrol, the government is involved in the setting of prices by means of price regulation.

definition

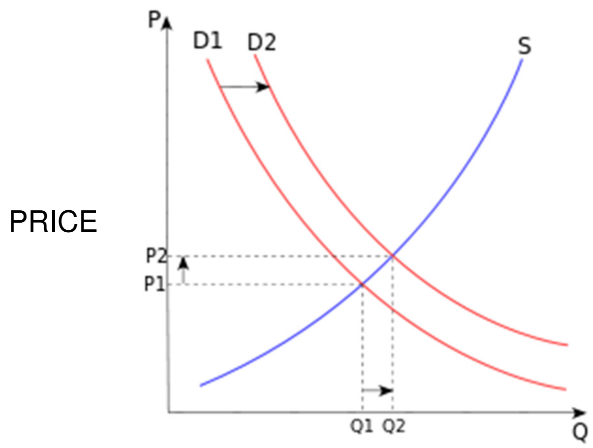
Supply and demand

Supply and demand is an economic model of price determination in a market. It concludes that in a competitive market, price will function to equalise the quantity demanded by consumers, and the quantity supplied by producers, resulting in an economic equilibrium of price and quantity.

Demand and Supply Curves

The supply-demand model is a partial equilibrium model representing the determination of the price of a particular product and the quantity of that product which is traded. Although it is normal to regard the quantity demanded and the quantity supplied as functions of the price of the product, the standard graphical representation, has price on the vertical axis and quantity on the horizontal axis, the opposite of the standard convention for the representation of a mathematical function.

Determinants of supply and demand other than the price of the product in question, such as consumers' income, input prices and so on, are not explicitly represented in the supply-demand diagram. Changes in the values of these variables are represented by shifts in the supply and demand curves. By contrast, responses to changes in the price of the product are represented as movements along unchanged supply and demand curves.



The price P of a product is determined by a balance between production at each price (supply S) and the desires of those with purchasing power at each price (demand D). The diagram above shows a positive shift in demand from D1 to D2, resulting in an increase in price (P) and quantity sold (Q) of the product.

Supply Schedule

The supply schedule, depicted graphically as the supply curve, represents the amount of some product that producers are willing and able to sell at various prices, assuming all determinants of supply other than the price of the product in question, such as technology and the prices of factors of production, remain the same.

Under the assumption of perfect competition, supply is determined by marginal cost. Firms will produce additional output as long as the cost of producing an extra unit of output is less than the price they will receive.

Demand Schedule

The demand schedule, depicted graphically as the demand curve, represents the amount of some product that buyers are willing and able to purchase at various prices, assuming all determinants of demand other than the price of the product in question, such as income, personal tastes, the price of substitute goods, and the price of complementary goods, remain the same. Following the law of demand, the demand curve is almost always represented as downward-sloping, meaning that as price decreases, consumers will buy more of the product.

Just as the supply curves reflect marginal cost curves, demand curves are determined by marginal utility curves. Consumers will be willing to buy a given quantity of a product, at a given price if the marginal utility of additional consumption is equal to the opportunity cost determined by the price, that is, the marginal utility of alternative consumption choices. The demand schedule is defined as the willingness and ability of a consumer to purchase a given product in a given frame of time.

As described above, the demand curve is generally downward-sloping. There may be rare examples of goods that have upward-sloping demand curves. Two different hypothetical types of goods with upward-sloping demand curves are Geffen goods (an inferior but staple product) and Veblen goods (products made more fashionable by a higher price).

Equilibrium

Equilibrium occurs where the quantity demanded is equal to the quantity supplied, represented by the intersection of the demand and supply curves.

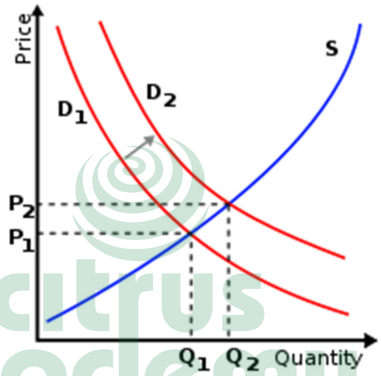
Relationship between Demand, Supply and Price

Demand Curve Shifts

When consumers increase the quantity demanded at a given price, it is referred to as an increase in demand. Increased demand can be represented on the graph as the curve being shifted to the right. At each price point, a greater quantity is demanded, as from the initial curve D1 to the new curve D2. In the diagram, this raises the equilibrium price from P1 to the higher P2. This raises the equilibrium quantity from Q1 to the higher Q2.

A movement along the curve is described as a "change in the quantity demanded" to distinguish it from a "change in demand," that is, a shift of the curve. In the example above, there has been an increase in demand which has caused an increase in (equilibrium) quantity. The increase in demand could also come from changing tastes and fashions, incomes, price changes in complementary and substitute goods, market expectations, and the number of buyers. This would cause the entire demand curve to shift changing the equilibrium price and quantity.

If the demand decreases, the opposite happens: a shift of the curve to the left. If the demand starts at D2, and decreases to D1, the price will decrease, and the quantity will decrease. This is an effect of demand changing. The quantity supplied at each price is the same as before the demand shift (at both Q1 and Q2). The equilibrium quantity, price and demand are different. At each point, a greater amount is demanded (when there is a shift from D1 to D2).



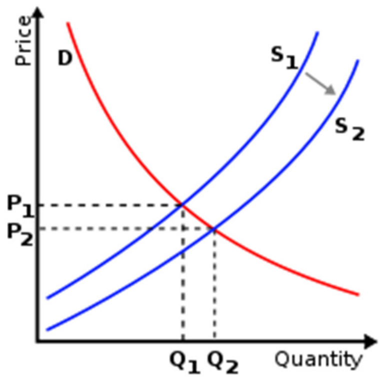
An outward or rightward shift in demand increases both equilibrium price and quantity

The demand curve shifts because a non-price determinant of demand has changed. Graphically the shift is due to a change in the x-intercept. A shift in the demand curve due to a change in a non-price determinant of demand will result in the market being in a non-equilibrium state. If the demand curve shifts out the result will be a shortage — at the new market price quantity demanded will exceed quantity supplied. If the demand curve shifts in, there will be a surplus — at the new market price quantity supplied will exceed quantity demanded.

Supply Curve Shifts

When the suppliers' costs change for a given output, the supply curve shifts in the same direction. For example, assume that someone invents a better way of growing oranges so that the cost of growing a given quantity of oranges decreases. Otherwise stated, producers will be willing to supply more oranges at every price and this shifts the supply curve S1 outward, to S2—an increase in supply. This increase in supply causes the equilibrium price to decrease from P1 to P2. The equilibrium quantity increases from Q1 to Q2 as the quantity demanded extends at the new lower prices. In a supply curve shift, the price and the quantity move in opposite directions.

If the quantity supplied decreases at a given price, the opposite happens. If the supply curve starts at S2, and shifts inward to S1, demand contracts, the equilibrium price will increase, and the equilibrium quantity will decrease. This is an effect of supply changing. The quantity demanded at each price is the same as before the supply shift (at both Q1 and Q2). The equilibrium quantity, price and supply changed.



An outward or rightward shift in supply reduces equilibrium price but increases quantity

When there is a change in supply or demand, there are four possible movements. The demand curve can move inward or outward. The supply curve can also move inward or outward.

Elasticity

Elasticity is a central concept in the theory of supply and demand. In this context, elasticity refers to how supply and demand respond to various factors, including price. One way to define elasticity is the percentage change in one variable divided by the percentage change in another variable (known as arc elasticity, which calculates the elasticity over a range of values, in contrast with point elasticity, which uses differential calculus to determine the elasticity at a specific point). It is a measure of relative changes.

Often, it is useful to know how the quantity demanded or supplied will change when the price changes. This is known as the price elasticity of demand and the price elasticity of supply. If a monopolist decides to increase the price of their product, how will this affect their sales revenue? Will the increased unit price offset the likely decrease in sales volume? If a government imposes a tax on a product, thereby increasing the effective price, how will this affect the quantity demanded?

Elasticity corresponds to the slope of the line and is often expressed as a percentage. In other words, the units of measure (such as one litre vs. 500 millilitres, say for the response of quantity demanded of milk to a change in price) do not matter, only the slope. Since supply and demand can be curves as well as simple lines the slope, and hence the elasticity, can be different at different points on the line.

Elasticity is calculated as the percentage change in quantity over the associated percentage change in price. For example, if the price moves from R 1-00 to R 2-00, and the quantity supplied goes from 100 pens to 102 pens, the slope is 2/0.05 or 40 pens per Rand. Since the elasticity depends on the percentages, the number of pens increased by 2%, and the price increased by 5%, so the price elasticity of supply is 2/5 or 0.4.

Since the changes are in percentages, changing the unit of measurement or the currency will not affect the elasticity. If the quantity demanded or supplied changes a lot when the price changes a little, it is said to be elastic. If the quantity changes little when the price changes a lot, it is said to be inelastic. An example of perfectly inelastic supply, or zero elasticity, is represented as a vertical supply curve (see below).

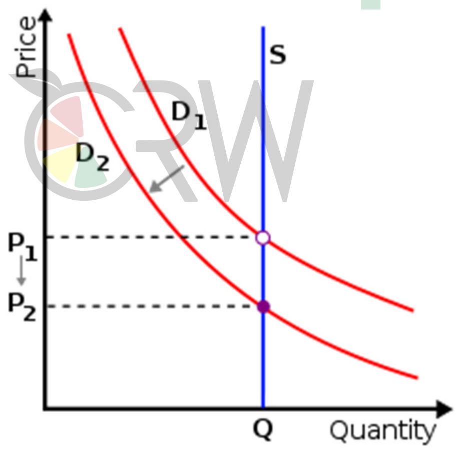
Elasticity in relation to variables other than price can also be considered. One of the most common to consider is income. How would the demand for a product change if income increased or decreased? This is known as the income elasticity of demand. For example, how much would the demand for a luxury car increase if average income increased by 10%? If it is positive, this increase in demand would be represented on a graph by a positive shift in the demand curve. At all price levels, more luxury cars would be demanded.

Another elasticity sometimes considered is the cross elasticity of demand, which measures the responsiveness of the quantity demanded of a product to a change in the price of another product. This is often considered when looking at the relative changes in demand when studying complement and substitute goods. Complement goods are goods that are typically utilised together, where if one is consumed, usually the other is also. Substitute goods are those where one can be substituted for the other, and if the price of one item rises, one may purchase less of it and instead purchase its substitute.

Cross elasticity of demand is measured as the percentage change in demand for the first product that occurs in response to a percentage change in the price of the second product. For an example with a complement product, if, in response to a 10% increase in the price of fuel, the number of new cars demanded decreased by 20%, the cross elasticity of demand would be -2.0.

In a perfect economy, any market should be able to move to the equilibrium position instantly without travelling along the curve. Any change in market conditions would cause a jump from one equilibrium position to another at once. So the perfect economy is actually analogous to the quantum economy. Unfortunately, in real economic systems, markets do not behave in this way, and both producers and consumers spend some time travelling along the curve before they reach the equilibrium position. This is due to asymmetric, or at least imperfect, information, where no one economic agent could ever be expected to know every relevant condition in every market. Ultimately both producers and consumers must rely on trial and error as well as prediction and calculation to find a true equilibrium of a market.

Vertical Supply Curve (Perfectly Inelastic Supply)



When demand D1 is in effect, the price will be P1. When D2 is occurring, the price will be P2. The quantity is always Q, any shifts in demand will only affect the price.

If the quantity supplied is fixed no matter what the price, the supply curve is a vertical line, and supply is called perfectly inelastic. In practice, vertical supply curves rarely exist.

As a hypothetical example, consider the supply curve of the land. Suppose that no matter how much someone would be willing to pay for an additional piece, more land cannot be created. Also, even if no one wanted all the land, it still would exist. In such a case, the land would have a vertical supply curve, with zero elasticity.

Production in the Economy

No trade of goods or services can take place if no goods or services exist. To create these goods or services, factors of production are employed to create goods or services. Thus factors of production are those things necessary to produce goods or services. Factors of production include:

Resources

For example timber, petroleum, minerals which are converted into furniture, petrol and steel (from iron), respectively. However, resources in themselves are raw materials and these can be traded as raw materials, but they can also be changed into value-added products through the use of machinery.

Labour

This could be inexpensive (usually menial labour) or expensive (service orientated and thus educated).

Materials

Such as the equipment needed to change a raw material into a refined product, for instance, a sugar mill, a steel mill or a paper mill.

Capital

The ability to raise the financial resources to purchase or pay for the factors of production so that the manufacturing of goods or the development of services can take place.

Entrepreneurship

The creative and risk-taking propensity of a population.

Factors of production are often not mobile between countries, but the goods and services produced by them are mobile. Thus, instead of importing Chinese labour to produce goods in South Africa, South Africa will import products from China made using Chinese labour in China.

Some factors of production are also not easily transferable between industries. For example, the owner of a steel mill is heavily invested in that capital asset. It is not very easy (actually impossible and unlikely) for this asset to be changed into a sugar mill. Labour similarly needs large amounts of re-education to move between industries.

It is because of this "immobility" between industries that governments must ensure that entering a certain industry would be viable and they would have to be willing to invest huge resources in starting up a new industry. Private sector role-players would obviously need to get involved to be able to take the industry forward through entrepreneurship. For this reason, it is very risky for countries to decide to enter a new industry without the necessary research.

The New Growth Path of South Africa has taken the position not to start new industries from scratch, but to add value to the raw material resources we already extract. In this way, we are building on current successful industries, but we are trying to increase the use of labour (job creation), added to the relevant technology (equipment), to add value to our existing products which can then be traded with higher income earning potential.

The Role of Money in a Market Economy

definition

Money

Money is any object or record that is generally accepted as payment for goods and services and repayment of debts (in other words cash and /or cheques.) The main functions of money are:

- A medium of exchange
- A unit of account
- A store of value

Any kind of object or secure verifiable record that fulfils these functions can serve as money.

Money originated as commodity money, but nearly all contemporary money systems are based on fiat money. Fiat money is without intrinsic use or value as a physical commodity and derives its value by being declared by a government to be legal tender. In other words, it must be accepted as a form of payment within the boundaries of the country, for "all debts, public and private."

The money supply of a country consists of currency (banknotes and coins) and bank money (the balance held in checking accounts and savings accounts). Bank money usually forms by far the largest part of the money supply.

practical

Complete the following formative assessment:

F263514.2 – Team Mind Map Presentation

Chapter 3
Factors that Influence Economic Activity

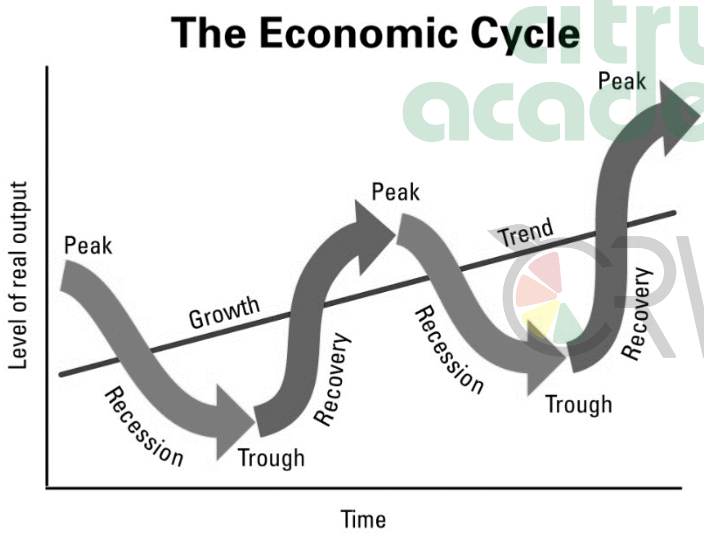
Cyclical Movements in a Market System

definition

Economic cycles

Economic cycle is the natural fluctuation of the economy between periods of expansion (growth) and contraction (recession). Factors such as gross domestic product (GDP), interest rates, levels of employment and consumer spending can help to determine the current stage of the economic cycle.

Defining Cycles in the Market Economy



One of the basic principles of economics is that if I spend R 1-00, somebody else earns it. From this economists have developed the concept of the economic cycle to illustrate how money flows between people in exchange for productive services, such as labour, or goods and services designed to satisfy humans' needs. In the simplest case exchange takes place between the individuals who supply their labour services to a firm, or group of firms, in exchange for a wage and in turn use these wages to purchase goods and services from producers. Thus, the individual acts as both consumer and supplier of the production factors.

Firms employ production factors in the creation of goods and services to satisfy man's needs.

Two main flows can thus be identified in the economic cycle.

- A flow of goods and services from the firms / organisations to the households
- The flow of resources to the firms / organisations

The households thus provide capital and labour, while organisations produce various products.

A Second Definition of the Business Cycle

The term business cycle (or economic cycle) refers to economy-wide fluctuations in production or economic activity over several months or years. These fluctuations occur around a long-term growth trend, and typically involve shifts over time between periods of relatively rapid economic growth (expansion or boom), and periods of relative stagnation or decline (contraction or recession).

These fluctuations are often measured using the growth rate of real gross domestic product (GDP). Despite being termed cycles, most of these fluctuations in economic activity do not follow a mechanical or predictable periodic pattern.

These fluctuations in the economy can be caused by (amongst others) overproduction or underconsumption, technology shocks, credit cycles (increase in private debt as a percentage of GDP increases economic expansions), the bursting of speculative bubbles, political reasons (change in political decisions due to changes in an administration).

The Concept of Inflation

In economics, inflation is a rise in the general level of prices of goods and services in an economy over a period of time. When the price level rises, each unit of currency buys fewer goods and services. Consequently, annual inflation is also an erosion in the purchasing power of money. A chief measure of price inflation is the inflation rate, the annualised percentage change in a general price index (normally the consumer price index - CPI) over time.

Inflation's effects on an economy are many and can be simultaneously positive and negative.

Negative effects of inflation include a decrease in the real value of money and other monetary items over time, uncertainty about future inflation may discourage investment and saving or may lead to reductions in the investment of productive capital and increase savings in non-producing assets, for example, selling stocks and buying gold. This can reduce overall economic productivity rates, as the capital required to retool companies becomes more elusive or expensive. High inflation may lead to shortages of goods if consumers begin hoarding out of concern that prices will increase in the future.

High or unpredictable inflation rates are regarded as harmful to an overall economy. They add inefficiencies in the market and make it difficult for companies to budget or plan long-term. Inflation can act as a drag on productivity as companies are forced to shift resources away from products and services in order to focus on profit and losses from currency inflation. Uncertainty about the future purchasing power of money discourages investment and saving. And inflation can impose hidden tax increases, as inflated earnings push taxpayers into higher income tax rates.

With high inflation, purchasing power is redistributed from those on fixed incomes such as pensioners towards those with variable incomes whose earnings may better keep pace with the inflation. This redistribution of purchasing power will also occur between international trading partners. Where fixed exchange rates are imposed, rising inflation in one economy will cause its exports to become more expensive and affect the balance of trade. There can also be negative impacts on trade from an increased instability in currency exchange prices caused by unpredictable inflation.

Cost-push Inflation

Rising inflation can prompt employees to demand higher wages, to keep up with consumer prices. Rising wages, in turn, can help fuel inflation. In the case of collective bargaining, wages will be set as a factor of price expectations, which will be higher when inflation has an upward trend.

This can cause a wage spiral. In a sense, inflation begets further inflationary expectations.

Hoarding

People buy consumer durables as stores of wealth in the absence of viable alternatives as a means of getting rid of excess cash before it is devalued, creating shortages of the hoarded objects.

Hyperinflation

If inflation gets totally out of control (in the upward direction), it can grossly interfere with the normal workings of the economy, hurting its ability to supply.

Allocative Efficiency

A change in the supply or demand for a product will normally cause its price to change, signalling to buyers and sellers that they should re-allocate resources in response to the new market conditions.

But when prices are constantly changing due to inflation, genuine price signals get lost in the noise, so agents are slow to respond to them. The result is a loss of allocative efficiency.

Shoe Leather Cost

High inflation increases the opportunity cost of holding cash balances and can induce people to hold a greater portion of their assets in interest paying accounts.

However, since cash is still needed in order to carry out transactions this means that more “trips to the bank” are necessary in order to make withdrawals, proverbially wearing out the “shoe leather” with each trip.

Menu Costs

With high inflation, firms must change their prices often in order to keep up with economy-wide changes. But often changing prices is itself a costly activity whether explicitly, as with the need to print new menus, or implicitly.

Business Cycles

Inflation sets off the business cycle. Artificially low interest rates and the associated increase in the money supply lead to reckless, speculative borrowing, resulting in clusters of mal-investments, which eventually have to be liquidated as they become unsustainable.

Positive effects of inflation include a mitigation of economic recessions, and debt relief by reducing the real level of debt.

Debt Relief

Debtors who have debts with a fixed nominal rate of interest will see a reduction in the "real" interest rate as the inflation rate rises. The "real" interest on a loan is the nominal rate minus the inflation rate (R=n-i). For example, if you take a loan where the stated interest rate is 6% and the inflation rate is at 3%, the real interest rate that you are paying for the loan is 3%. It would also hold true that if you had a loan at a fixed interest rate of 6% and the inflation rate jumped to 20% you would have a real interest rate of -14%. Banks and other lenders adjust for this inflation risk either by including an inflation premium in the costs of lending the money by creating a higher initial stated interest rate, or by setting the interest at a variable rate.

Room to Manoeuvre

The primary tools for controlling the money supply are the ability to set the discount rate, the rate at which banks can borrow from the central bank, and open market operations which are the central bank's interventions into the bonds market with the aim of affecting the nominal interest rate. If an economy finds itself in a recession with already low, or even zero, nominal interest rates, then the bank cannot cut these rates further (since negative nominal interest rates are impossible) in order to stimulate the economy. This situation is known as a liquidity trap. A moderate level of inflation tends to ensure that nominal interest rates stay sufficiently above zero so that if the need arises the bank can cut the nominal interest rate.

Tobin Effect

The Nobel Prize-winning economist James Tobin at one point had argued that a moderate level of inflation can increase investment in an economy leading to faster growth or at least higher steady state level of income. This is due to the fact that inflation lowers the return on monetary assets relative to real assets, such as physical capital. To avoid inflation, investors would switch from holding their assets as money (or a similar, susceptible to inflation, form) to investing in real capital projects.

Inflation Targeting

Economists generally agree that high rates of inflation and hyperinflation are caused by an excessive growth of the money supply. Views on which factors determine low to moderate rates of inflation are more varied. Low or moderate inflation may be attributed to fluctuations in real demand for goods and services, or changes in available supplies such as during scarcities, as well as to growth in the money supply. However, the consensus view is that a long sustained period of inflation is caused by money supply growing faster than the rate of economic growth.

Today, most mainstream economists favour a low steady rate of inflation. Low (as opposed to zero or negative) inflation may reduce the severity of economic recessions by enabling the labour market to adjust more quickly in a downturn, and reduce the risk that a liquidity trap prevents monetary policy from stabilising the economy. The task of keeping the rate of inflation low and stable is usually given to monetary authorities. Generally, these monetary authorities are the central banks that control the size of the money supply through the setting of interest rates, through open market operations, and through the setting of banking reserve requirements.

Why does Money Devalue?

definition

Devaluation

Devaluation is a reduction in the value of a currency with respect to those goods, services or other monetary units with which that currency can be exchanged.

In common modern usage, it specifically implies an official lowering of the value of a country's currency within a fixed exchange rate system, by which the monetary authority formally sets a new fixed rate with respect to a foreign reference currency (such as the US dollar, the European Euro or the British Pound).

Inflation, on the other hand, refers to the value of the currency in goods and services (related to its purchasing power).

Present day currencies are usually fiat currencies with insignificant inherent value. The value of the currency is determined by the interplay of money supply and money demand. As some countries hold floating exchange rates, others maintain fixed exchange rate policy against the United States dollar or other major currencies. These fixed rates are usually maintained by a combination of legally enforced capital controls or through government trading of foreign currency reserves to manipulate the money supply. Under fixed exchange rates, persistent capital outflows or trade deficits may lead countries to lower or abandon their fixed rate policy, resulting in a devaluation (as persistent surpluses and capital inflows may lead them towards revaluation).

Generally, a steady process of inflation is not considered a devaluation, although if a currency has a high level of inflation, its value will naturally fall against gold or foreign currencies. Especially where a country deliberately prints money (a usual cause of hyperinflation) to cover a persistent budget deficit without borrowing, this may be considered a devaluation.

Foreign Currency and Exchange Rates

It is widely accepted that no country can function without obtaining goods and services from foreign countries. The foreign sector can thus be a source of or destination for goods and services. Exports are when goods and services are sold to other countries, and in return, the business receives money. This money then flows into the economic cycle. Exports from South Africa include not only minerals such as gold, diamonds and platinum but also agricultural products such as citrus fruit.

Imports are when organisations buy goods from foreign countries for use in South Africa. Goods are thus received which have to be paid for. Money is then sent out of the country to pay for these goods. If exports increase, it means that we are able to sell our goods overseas, thus boosting national income. More money is thus flowing into the country. Production has to be increased, and this leads to increased work opportunities within this country as well as an increase in the national income (or GDP).

The more goods we export and the more foreign currency we earn, the more able we are to buy foreign products that we cannot manufacture ourselves, the more able we are to pay off foreign debt (if we have any), the stronger our economy becomes, and, generally, the stronger our currency becomes in relation to other currencies.

Gold is South Africa's biggest export item (approximately 30%), hence it has a major effect on the South African economy. If the gold price or exports are low, downward pressure is put on the Rand, causing upward pressure on interest rates.

information

The effects of labour unrest

When unions strike over wage disputes, the cost of products increase and less is sold. This directly affects foreign earnings and the strength of the economy. The more productive or efficient we can be (output of product per cost of unit labour) the more competitive prices will be. We will sell more product to foreign markets (export) and thus strengthen the economy.

Conclusion: Strikes are not healthy for the economy!!

The exchange rate refers to the value of one currency in terms of other currencies, in other words, the Rand to the Japanese Yen or to the German Euro or to the American Dollar. It refers to the supply and demand for Rand, which is used for exports, investment, imports and disinvestment. If there is an excess of Rands in the market, the value will decrease, leading to a decrease in the exchange rate.

The foreign exchange market (forex, FX, or currency market) is a worldwide decentralised over-the-counter financial market for the trading of currencies. Financial centres around the world function as anchors of trading between a wide range of different types of buyers and sellers around the clock, with the exception of weekends.

The purpose of the foreign exchange market, or forex, is to assist international trade and investment. The foreign exchange market allows businesses to convert one currency to another foreign currency. For example, it permits a US business to import European goods and pay Euros, even though the business's income is in US dollars.

In a typical foreign exchange transaction, a party purchases a quantity of one currency by paying a quantity of another currency.

Economic Factors that Influence Foreign Exchange

These include:

- Economic policy, disseminated by government agencies and central banks
- Economic conditions, generally revealed through economic reports and other economic indicators
- Economic policy comprises government fiscal policy (budget / spending practices) and monetary policy (the means by which a government's central bank influences the supply and "cost" of money, which is reflected by the level of interest rates).
- Government budget deficits or surpluses: The market usually reacts negatively to widening government budget deficits, and positively to narrowing budget deficits. The impact is reflected in the value of a country's currency.

- Balance of trade levels and trends: The trade flow between countries illustrates the demand for goods and services, which in turn indicates demand for a country's currency to conduct trade. Surpluses and deficits in trade of goods and services reflect the competitiveness of a nation's economy. For example, trade deficits may have a negative impact on a nation's currency.
- Inflation levels and trends: Typically a currency will lose value if there is a high level of inflation in the country or if inflation levels are perceived to be rising. This is because inflation erodes purchasing power, thus demand, for that particular currency. However, a currency may sometimes strengthen when inflation rises because of expectations that the central bank will raise short-term interest rates to combat rising inflation.
- Economic growth and health: Reports such as GDP, employment levels, retail sales, capacity utilisation and others, detail the levels of a country's economic growth and health. Generally, the more healthy and robust a country's economy, the better its currency will perform, and the more demand for it there will be.
- Productivity of an economy: Increasing productivity in an economy should positively influence the value of its currency. Its effects are more prominent if the increase is in the traded sector.

Political Conditions that Influence Foreign Exchange

Internal, regional, and international political conditions and events can have a profound effect on currency markets.

All exchange rates are susceptible to political instability and anticipations about the new ruling party. Political upheaval and instability can have a negative impact on a nation's economy. For example, destabilisation of coalition governments in Pakistan and Thailand can negatively affect the value of their currencies. Similarly, in a country experiencing financial difficulties, the rise of a political faction that is perceived to be fiscally responsible can have the opposite effect. Also, events in one country in a region may spur positive / negative interest in a neighbouring country and, in the process, affect its currency.

The Interest / BA Rate, Gross Domestic Product and Balance of Payments in my Business

Interest Rates

Supply and demand determine the interest rates being charged. The interest rate is the cost of lending money. In South Africa, the interest rate is monitored by the South Africa Reserve Bank.

Money is offered at a particular interest rate by the financial sector. If potential borrowers are of the opinion that the rate is too high, they will delay their application for credit until the cost is less (prudent borrowers will do this – reckless borrowers will go ahead with their credit applications regardless of the interest rate).

The prime-lending rate is the best interest rate paid by the best clients of the bank. The prime rate is also that interest rate quoted the most, thus the most representative rate. All other interest rates move with the prime rate. If people deposit money in financial institutions through savings and investment products, that money is not spent on goods and services. This reduces the inflationary potential within the economy. Savings also have an effect on prices, as demand is less than supply. Money saved in financial institutions is lent out to other enterprises for expansion.

When banks lend out more money than they receive they go to the South African Reserve Bank and borrow from them at the official bank rate (Repo rate). The official bank rate is 3% less than the prime rate (which accounts for the profit of the bank). When banks need to borrow from the Reserve Bank this is known as a shortage in the money market. The bank rate affects all interest rates charged by the banks, not only the prime rate. In this way, monetary policy can affect the economy as a whole.

Interest rates targets are also a vital tool of monetary policy and are taken into account when dealing with variables like investment, inflation and unemployment.

BA Rate

The BA Rate stands for the bankers acceptances rate. A bankers acceptance is a private bank note that guarantees the holder repayment of the sum displayed on it. The bank accepts a deposit from an investor for a specific period of time, at a specific interest rate which will be paid at the end of the period. Thus the BA rate serves as an indication of the future movement of the commercial interest rates. A banker's acceptance is also a money market instrument – a short-term discount instrument that usually arises in the course of international trade.

Acceptances arise most often in connection with international trade. For example, an American importer may request acceptance financing from its bank when, as is frequently the case in international trade, it does not have a close relationship with and cannot obtain financing from the exporter it is dealing with. Once the importer and bank have completed an acceptance agreement, in which the bank agrees to accept drafts for the importer and the importer agrees to repay any drafts the bank accepts, the importer draws a time draft on the bank. The bank accepts the draft and discounts it. In other words, it gives the importer cash for the draft but gives it an amount less than the face value of the draft. The importer uses the proceeds to pay the exporter.

The bank may hold the acceptance in its portfolio or it may sell, or rediscount it in the secondary market. In the former case, the bank is making a loan to the importer. In the latter case, it is in effect substituting its credit for that of the importer, enabling the importer to borrow in the money market. On or before the maturity date, the importer pays the bank the face value of the acceptance. If the bank rediscounted the acceptance in the market, the bank pays the holder of the acceptance the face value on the maturity date.

Gross Domestic Product

The amount of economic activity within a country is measured by the GDP (gross domestic product). It is the market value of all final goods and services made within the borders of a country in a year. "Domestic" means that GDP measures production that takes place within the country's borders. Economic activity is not stable all the time but constantly fluctuating. During periods of high economic activity, known as a boom or upswing, economic growth increases and is often accompanied by increased investment and employment. During periods of reduced (or low) economic activity, unemployment increases while investment and growth decreases. This is known as a recession or a depression if it is particularly severe and it continues for an extended period of time.

Some problems with using GDP as a measure of an economy's health include:

- Wealth distribution – GDP does not take disparity in incomes between the rich and poor into account.
- Non-market transactions – GDP excludes activities that are not provided through the market, such as household production and volunteer or unpaid services. As a result, GDP is understated. For example, unpaid work conducted on Free and Open Source Software (such as Linux) contribute nothing to GDP, but it was estimated that it would have cost more than a billion US dollars for a commercial company to develop. Also, if Free and Open Source Software became identical to its proprietary software counterparts, and the nation producing the propriety software stops buying proprietary software and switches to Free and Open Source Software, then the GDP of this nation would reduce. However, there would be no reduction in economic production or standard of living. The work of New Zealand economist Marilyn Waring has highlighted that if a concerted attempt to factor in unpaid work were made, then it would in part undo the injustices of unpaid (and in some cases, slave) labour, and also provide the political transparency and accountability necessary for democracy. Shedding some doubt on this claim, however, is the theory that won economist Douglass North the Nobel Prize in 1993. North argued that the creation and strengthening of the patent system, by encouraging private invention and enterprise, became the fundamental catalyst behind the Industrial Revolution in England.
- Underground economy – Official GDP estimates may not take into account the underground economy, in which transactions contributing to production, such as illegal trade and tax-avoiding activities, are unreported, causing GDP to be underestimated.
- Non-monetary economy – GDP omits economies where no money comes into play at all, resulting in inaccurate or abnormally low GDP figures. For example, in countries with major business transactions occurring informally, portions of the local economy are not easily registered. Bartering may be more prominent than the use of money, even extending to services ("I helped you build your house ten years ago, so now you help me").
- GDP also ignores subsistence production.
- Quality improvements and the inclusion of new products – By not adjusting for quality improvements and new products, GDP understates true economic growth. For instance, although computers today are less expensive and more powerful than computers from the past, GDP treats them as the same products by only accounting for the monetary value. The introduction of new products is also difficult to measure accurately and is not reflected in GDP despite the fact that it may increase the standard of living. For example, even the richest person from 1900 could not purchase standard products, such as antibiotics and cell phones that an average consumer can buy today since such modern conveniences did not exist back then.
- What is being produced – GDP counts work that produces no net change or that results from repairing harm. For example, rebuilding after a natural disaster or war may produce a considerable amount of economic activity and thus boost GDP. The economic value of health care is another classic example. It may raise GDP if many people are sick and they are receiving expensive treatment, but it is not a desirable situation. Alternative economic estimates,

such as the standard of living or discretionary income per capita try to measure the human utility of economic activity.

- Externalities – GDP ignores externalities or economic negatives such as damage to the environment. By counting goods which increase utility but not deducting those that have a negative influence or accounting for the negative effects of higher production, such as more pollution, GDP is overstating economic welfare. The genuine progress indicator (GPI) is thus proposed by ecological economists and green economists as a substitute for GDP, supposing a consensus on relevant data to measure "progress". In countries highly dependent on resource extraction or with high ecological footprints the disparities between GDP and GPI can be very large, indicating ecological overshoot. Some environmental costs, such as cleaning up oil spills are included in GDP.
- Sustainability of growth – GDP is not a tool of economic projections, which would make it subjective, it is just a measurement of economic activity. That is why it does not measure what is considered the sustainability of growth. A country may achieve a temporarily high GDP by over-exploiting natural resources or by misallocating investment. For example, the large deposits of phosphates gave the people of Nauru one of the highest per capita incomes on earth, but since 1989 their standard of living has declined sharply as the supply has run out. Oil-rich states can sustain high GDPs without industrialising, but this high level would no longer be sustainable if the oil runs out. Economies experiencing an economic bubble, such as a housing bubble or stock bubble, or a low private saving rate tend to appear to grow faster owing to higher consumption, mortgaging their futures for present growth. Economic growth at the expense of environmental degradation can end up costing dearly to clean up.
- One main problem in estimating GDP growth over time is that the purchasing power of money varies in different proportion for different goods, so when the GDP figure is deflated over time, GDP growth can vary greatly depending on the basket of goods used and the relative proportions used to deflate the GDP figure. For example, in the past 80 years the GDP per capita of the United States if measured by purchasing power of potatoes, did not grow significantly. But if it is measured by the purchasing power of eggs, it grew several times. For this reason, economists comparing multiple countries usually use a varied basket of goods.

Cross-border comparisons of GDP can be inaccurate as they do not take into account local differences in the quality of goods, even when adjusted for purchasing power parity. This type of adjustment to an exchange rate is controversial because of the difficulties of finding comparable baskets of goods to compare purchasing power across countries. For instance, people in country "A" may consume the same number of locally produced oranges as in country "B", but oranges in country "A" are of a more tasty variety. This difference in material well-being will not show up in GDP statistics. This is especially true for goods that are not traded globally, such as housing.

Alternatives to GDP

- Human development index (HDI) – HDI uses GDP as a part of its calculation and then factors in indicators of life expectancy and education levels.
- Genuine progress indicator (GPI) or index of sustainable economic welfare (ISEW) - The GPI and the ISEW attempt to address many of the above criticisms by taking the same raw information supplied for GDP and then to

make adjustments for income distribution, by adding for the value of household and volunteer work, and subtracting for crime and pollution.

- Gini coefficient – The Gini coefficient measures the disparity of income within a nation.
- Wealth estimates – The World Bank has developed a system for combining monetary wealth with intangible wealth (institutions and human capital) and environmental capital.
- Private product remaining – Murray Newton Rothbard and other Austrian economists argue that because government spending is taken from productive sectors and produces goods that consumers do not want, it is a burden on the economy and thus should be deducted. In his book, America's Great Depression, Rothbard argues that even government surpluses from taxation should be deducted to create an estimate of PPR.
- Some people have looked beyond the standard of living at a broader sense of the quality of life or well-being:
    - European Quality of Life Survey – The survey, first published in 2005, assessed quality of life across European countries through a series of questions on overall subjective life satisfaction, satisfaction with different aspects of life, and sets of questions used to calculate deficits of time, loving, being and having.
    - Gross national happiness – The Centre for Bhutanese Studies in Bhutan is working on a complex set of subjective and objective indicators to measure national happiness in various domains (living standards, health, education, eco-system diversity and resilience, cultural vitality and diversity, time use and balance, good governance, community vitality and psychological well-being). This set of indicators would be used to assess progress towards gross national happiness, which they have already identified as being the nation's priority, above GDP.
    - Happy planet index – The happy planet index (HPI) is an index of human well-being and environmental impact, introduced by the New Economics Foundation (NEF) in 2006. It measures the environmental efficiency with which human well-being is achieved within a given country or group. Human well-being is defined in terms of subjective life satisfaction and life expectancy while environmental impact is defined by the Ecological Footprint.

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Complete the following formative assessment:

F263514.3 – Class Discussion with Key Notes

Chapter 4
Development and Significance of Markets

International Trade

definition

International trade

International trade can be defined as the exchange of capital, goods, and services across international borders or territories. It refers to exports of goods and services by a firm to a foreign-based buyer (importer). In most countries, it represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history, its economic, social, and political importance has been on the rise in recent centuries.

Industrialisation, advanced transportation, globalisation, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalisation. International trade is a major source of economic revenue for any nation that is considered a world power. Without international trade, nations would be limited to the goods and services produced within their own borders.

International trade is in principle not different from domestic trade as the motivation and the behaviour of parties involved in a trade do not change fundamentally regardless of whether the trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or culture.

Another difference between domestic and international trade is that factors of production such as capital and labour are typically more mobile within a country than across countries. Thus international trade is mostly restricted to trade in goods and services, and only to a lesser extent to trade in capital, labour or other factors of production. Instead of importing a factor of production, a country can import goods that make intensive use of the factor of production and are thus embodying the respective factor. An example is the import of labour-intensive goods by the United States from China. Instead of importing Chinese labour the United States is importing goods from China that were produced with Chinese labour.

Regulation of International Trade

Traditionally trade was regulated through bilateral treaties between two nations. For centuries under the belief in mercantilism, most nations had high tariffs and many restrictions on international trade. In the 19th century, especially in the United Kingdom, a belief in free trade became paramount. This belief became the dominant thinking among western nations since then. In the years since the Second World War, controversial multilateral treaties like the General Agreement on Tariffs and Trade (GATT) and World Trade Organisation have attempted to promote free trade while creating a globally regulated trade structure. These trade agreements have often resulted in discontent and protest with claims of unfair trade that is not beneficial to developing countries.

Free trade is usually most strongly supported by the most economically powerful nations, though they often engage in selective protectionism for those industries which are strategically important such as the protective tariffs applied to agriculture by the United States and Europe. The Netherlands and the United Kingdom were both strong advocates of free trade when they were economically dominant. Today the United States, the United Kingdom, Australia and Japan are its greatest proponents. However, many other countries (such as India, China and Russia) are increasingly becoming advocates of free trade as they become more economically powerful themselves. As tariff levels fall there is also an increasing willingness to negotiate non-tariff measures, including foreign direct investment, procurement and trade facilitation. The latter looks at the transaction cost associated with meeting trade and customs procedures.

Traditionally agricultural interests are usually in favour of free trade while manufacturing sectors often support protectionism. This has changed somewhat in recent years, however. In fact, agricultural lobbies, particularly in the United States, Europe and Japan, are chiefly responsible for particular rules in the major international trade treaties which allow for more protectionist measures in agriculture than for most other goods and services.

During recessions, there is often strong domestic pressure to increase tariffs to protect domestic industries.

The regulation of international trade is done through the World Trade Organisation at the global level and through several other regional arrangements such as MERCOSUR in South America, the North American Free Trade Agreement (NAFTA) between the United States, Canada and Mexico, and the European Union between 27 independent states. The 2005 Buenos Aires talks on the planned establishment of the Free Trade Area of the Americas (FTAA) failed largely because of opposition from the populations of Latin American nations. Similar agreements such as the Multilateral Agreement on Investment (MAI) have also failed in recent years.

The Balance of Trade

The balance of trade (or net exports, sometimes symbolised as NX) is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports. A favourable balance of trade is known as a trade surplus and consists of exporting more than is imported. An unfavourable balance of trade is known as a trade deficit or, informally, a trade gap. The balance of trade is sometimes divided into a goods and a services balance.

The Importance of New Ventures

On average (internationally) small, medium and micro-enterprises enterprises (SMMEs) contribute 60% of GDP and 70% of total employment. In developing countries, SMMEs account for 90% of all firms outside of the agricultural sector. In Japan and the USA, SMMEs account for 60% and 40% respectively of all companies. Small, medium and micro-enterprises enterprises contribute 34% to South Africa's GDP.

New ventures, start-ups and SMMEs are important for the development of South Africa, because:

- They lead to technological innovations
- Stimulate private ownership
- Stimulate entrepreneurial skills
- SMMEs can adapt quickly to market demands
- They increase the competitiveness of the marketplace
- They facilitate the output of goods and services
- Create jobs at low capital cost
- They develop a pool of skilled and semi-skilled workers
- Reduce income disparities
- Improve forward and backwards linkages across diverse sectors

Growth Sectors in South Africa

South Africa's economy was traditionally rooted in the primary sectors - the result of a wealth of mineral resources and favourable agricultural conditions. But recent decades have seen a structural shift in output.

Since the early 1990s, economic growth has been driven mainly by the tertiary sector, which includes wholesale and retail trade, tourism and communications. Now South Africa is moving towards becoming a knowledge-based economy, with a greater focus on technology, e-commerce and financial and other services.

Among the key sectors that contribute to the gross domestic product and keep the economic engine running are manufacturing, retail, financial services, communications, mining, agriculture and tourism.

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Complete the following formative assessment:

F263514.4 – Team Research Mind Map Presentations

Section 1: Self-Assessment and Progress Check

Explain the free market system in terms of perfect and imperfect competitive markets.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Give an explanation of the characteristics of different economic systems.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain the role of competition in a free market system and give examples from state-owned business and the private sector.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Illustrate competition by listing prices for the same product or service.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Describe and give examples of reasons for imperfect competitiveness.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain and give examples of the advantages and disadvantages of competition.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Give a description of the interaction of role-players in the economic system.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain the conditions for the existence of perfect and imperfect markets in the South African context.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Analyse the interaction of demand and supply in price determination, under perfectly competitive market conditions.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment

Explain the laws of demand and supply.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain the consequences of the law of demand and supply for new ventures.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain the relationship between variables of demand and supply curves.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Discuss the relationship between demand, supply and price in terms of agricultural produce.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
List factors that lead to changes in demand and supply curves for agricultural produce.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain factors of production in terms of roles and contribution to the economy.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Explain the role that money plays in terms of the economy.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Analyse the factors that influence economic activity.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Evaluate the effects of cyclical movements in the market system on a citrus production unit.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Describe the concept of inflation and how it impacts new agribusinesses.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment

Identify reasons for the decline in the value of money.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Explain the role of foreign currency and exchange rates in the general economy.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Explain the role of interest rates, gross domestic product and balance of payments in operations of an agribusiness.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Describe the development and significance of markets (with relevance to South Africa).	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Investigate international trade as a result of uneven resource distribution with reference to opportunities for a new agribusiness.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Identify socio-economic factors that underline the importance of new business development in South Africa.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Identify and classify existing growth sectors in South Africa and explain how it may influence new agribusiness ventures.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Section 2: Contractual Agreements

Learning Goals and Pathways

Contractual agreements are a cornerstone of business. Whilst it is not necessary to study the law to the point of becoming a lawyer, it is necessary to understand the rules, obligations and consequences of contractual law.

This section will help you to explore and understand the structure and administration of typical contractual agreements in business.

This section is presented in chapters 5 to 8 of the guide.

The learning goals for this module include:

1. Understand and explain contract administration principles and techniques.
2. Apply basic risk management techniques in managing performance.
3. Demonstrate an understanding of contract changes and disputes.
4. Ensure compliance and administrative close-out of contract.

Chapter 5
Contract Administration

What Is Contracting?

A contract is a legal document, a binding agreement between two or more persons that is enforceable by law.

General Requirements

1. Legal Capacity

Legal capacity is the capacity of an individual to conduct legal acts. A legal act is an act in which the law recognises the legal consequences as those intended by the individual. The capacity of parties to conclude contracts depends on whether the party is a natural person, in other words, an individual or groups of individuals such as a partnership or a legal person, for example, a company or close corporation (CC).

- Natural persons. Barring certain exceptions such as minors or mentally disturbed people, all natural persons have full contractual capacity. In short, it implies that a person must be able to conclude a contract and act accordingly. Individuals under the age of seven years, mentally retarded individuals and individuals under the influence of liquor or drugs have no contractual capacity. They cannot enter into any legal activity such as closing a contract.
- A minor (that is an unmarried person under the age of eighteen, but who is above the age seven) or insolvents have limited contractual capacity and must be assisted or represented by their parents or guardians.
- Legal persons. A legal person has full capacity and is able to perform all those legal acts which fall within the legal capacity of the legal person as determined the memorandum or constitution. The general rule with regard to companies and close corporations (CCs) is that they have full contractual capacity to perform any act. If the entrepreneur chooses to run a business in a form of a company or close corporation, there is no limitation to the nature of contracts which may be concluded.

2. Legality

A contract is illegal if it is prohibited by statute or common law, or if it is contrary to public policy or good morals. The reason for the illegality may, in fact, be that the purpose of the contract is legally prohibited, for example, to buy uncut diamonds or that the nature of the contract is contrary to public policy, for example, to commit crime.

3. Formalities

The formalities, with which an agreement must in certain circumstances comply, may be prescribed by statute or parties themselves. The most common legal requirement in this regard is that certain contracts must be in writing. For example, the law requires that all contracts for alienation of fixed property and suretyship must be in writing. The parties to an agreement may stipulate that a contract which need not be in writing must be put in writing before it becomes binding.

4. Performance Must be Possible

The performance agreed to by the parties must be possible at the time of the conclusion of the contract. The parties must objectively be able to deliver at the time of the conclusion of the contract. If one sells a goat, but the goat had already been slaughtered at the time of conclusion, the carcass delivered to a butchery and already sold to the public, the performance is objectively impossible. No contract came into existence. If the goat belonged to the third party at the time of conclusion of the contract, a valid contract objectively came into existence. Nothing prevented the seller from buying from the third party and delivering it to the buyer.

5. Performance must be Certain or Ascertainable

If the performance to be effected is so vague or so vaguely described that the parties themselves are not sure what is required, a valid contract is out of the question. If an individual, for example, sells a car without stipulating the model and registration number, the performance is neither certain nor ascertainable.

6. Consensus

Consensus between parties forms the basis of any contract. Each of the contracting parties forms a will and the will of each party must correspond with that of the other. Conscious cooperation between the parties is further required. If the one party, for example, intends to hire a room, and the other party intends to lease the specific apartment, their intentions merely coincide but there is no active cooperation. Unanimity is obtained when one person makes an offer, and the other party accepts the offer. The will of the respective parties now corresponds.

Purpose of Contracts

Contracts are crucial to any kind of business. Despite their importance, they are simple in principle: an agreement is reached between two or more parties, with consideration flowing both ways. "Consideration" means the value given up to enter into an agreement. It might be money, an in-kind transaction, a promise not to do something, or anything else of value. Contracts fulfil three roles:

- They provide certainty. A properly worded contract lets each party know what they will be obtaining, and what they will be surrendering. How much detail this requires is up to the parties.
- They help avoid and settle disputes. Contracts force parties to think about issues beforehand. This means that they can turn their minds to avoiding problems, or setting up methods to resolve disagreements. This often avoids arguments altogether. Contracts may also include a way of quickly resolving disputes, such as mediation or arbitration.
- They balance the risks. In an ideal contract, each party should feel it has received at least as much as it has given away. This is not always accomplished,

of course, but an important role of a contract is that each side can decide what is most important to them.

Every contract needs to balance risk and reward. Contracts are a complex blend of variables, and it is up to the contractors to determine which are the most important to them.

Here is an example: A producer has two potential buyers of lemons. One buyer has been in business for 60 years, is financially solid, but has a reputation of paying the bare minimum price. The other buyer was formed only a few months ago and is paying a 10% premium over spot lemon prices. Which one should the farmer sell to?

There is no right or wrong answer. It is the producer's choice whether he / she takes the stability of the first buyer, with less risk of default. Alternatively, it can choose the higher prices of the second company, realising that without a track record, there may be a higher risk of the company not being in business after harvest to pay the contract.

What the producer should not do is expect to get everything, in this case, high prices and financial stability. Almost everything in life involves scarce resources, and offering more in one area usually takes resources away from another. Parties will distinguish themselves by promoting certain aspects of their product or business practices. This almost always results in a cost somewhere else. This is nothing more than the principle that "there is no free lunch", but it definitely applies to contracting.

More importantly, a contract that is completely one-sided rarely works out. Any party that gains nothing from an agreement will have little incentive to complete its obligations. The lack of a reasonable return may even threaten its very existence. Recognise that the other party needs to get something out of the contract as well. This does not mean that anybody should surrender and accept everything that is proposed in a contract. Be tough when bargaining, but be fair.

Procurement

One of the most common activities in getting your work done efficiently, and that you as an entrepreneur need to understand and practice almost daily, is called "procurement". Your services and products will also be procured by your clients.

This concept refers to:

The acquisition of goods and / or services at the best possible total cost, in the right quality and quantity, at the right time, in the right place and from the right source for the direct benefit or use of the enterprise, generally via a contract.

Simple procurement may involve nothing more than repeat purchasing. Complex procurement could involve finding long-term partners, or even co-destiny suppliers that might fundamentally commit one organisation to another.

A similar word for procurement is "outsourcing" which can also be defined as follows:

Outsourcing is often viewed as involving the contracting out of a business function to an external provider. In this sense, two organisations may enter into a contractual agreement involving an exchange of services and payments.

- All public and private organisations have what is known as "the functions of management" which refer to the following:
  - Administration
  - Marketing management
  - General management

- Human resources management
- Public relations
- Information technology management
- Purchasing
- Financial management
- Operations management

A business owner needs to pay careful attention to each of these functions in order to ensure the successful operation of his business. These functions can be efficiently managed if activities are broken down into smaller projects that need to be carried out either daily, weekly, monthly or annually.

Your enterprise may not have all the resources (human capacity, financial, infrastructural or equipment resources) it needs to carry out all management functions. For example, the information technology (IT) functions of a business require specific skills and resources which your company may not possess. The following resources, tools, skills and equipment are needed for the information technology of your company to function:

- Computers
- Computer networks
- Computer software
- Internet (telephone lines)
- Installation of computer software, anti-virus software and repair of damaged computers, virus infected computers and networks and setting up of networks.
- Cell phone (cell phone networks)
- Photocopying machines
- Fax machines
- Printing machine (printer)
- Telephone
- Computer technician(s), software developer, web developer and networker.

Therefore, when you identify that certain resources and skills are not available within your enterprise, then an outsourcing or procurement option is considered.

On the converse, your enterprise wishes to provide services or products to companies or organisations that require these services or products. Thus, just as you will engage with the process of procurement or outsourcing for the needs of your enterprise, you will also be involved in the process of procurement or outsourcing as the service or product supplier.

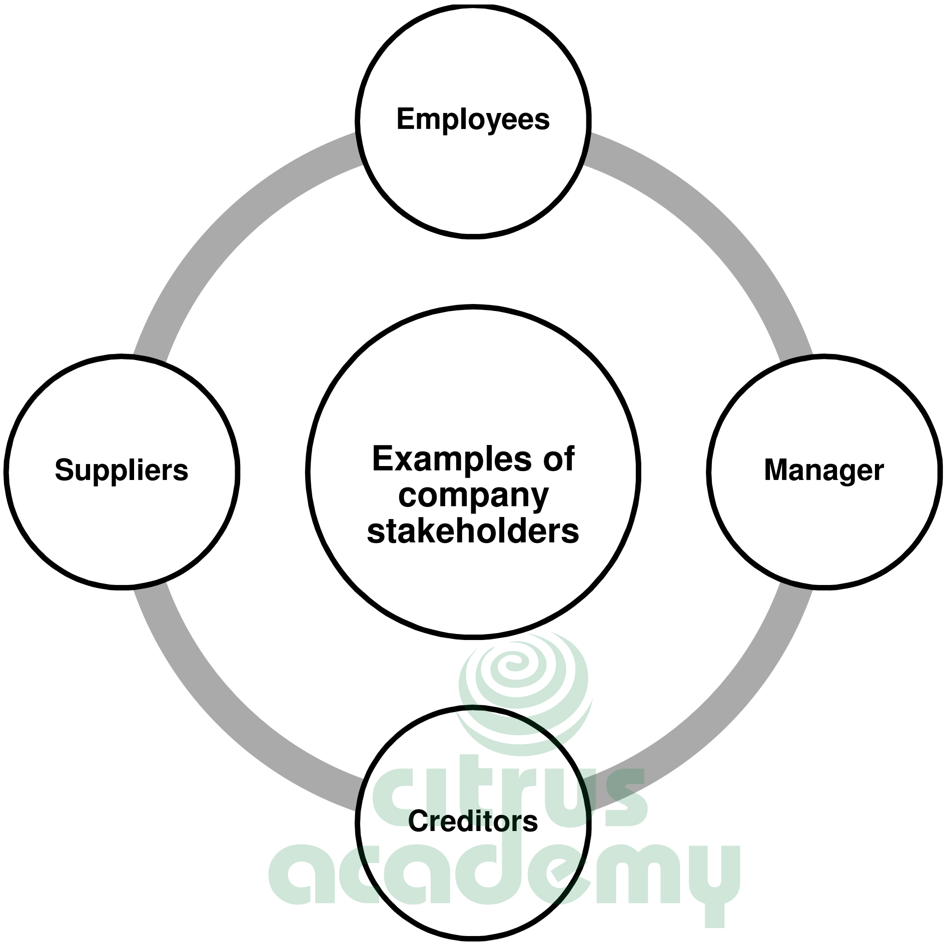
Keep this in mind as you work through this unit standard. See things from your own perspective as well as from the perspective of your clients.

Informing Relevant Stakeholders and Role-players

Who are role-players or stakeholders in the business environment?

A business stakeholder or role-player is an individual or party that can affect or be affected by the actions of the business as a whole.

The following graphic illustrates some of the role-players or stakeholders that are involved when an enterprise determines that it needs to purchase an outside product or service:



Depending on the type of service or product procured by a company, these are the main stakeholders that will always need to be consulted when procuring.

Remember, you may be the "supplier" in the above diagram if your services or products are being procured by others, or you could be the "manager" or "employee" in the above diagram where you are procuring the services or products of others.

Determining Performance Requirements

Outsourcing or procurement of services or products always comes as a result of a need. There are various reasons why an organisation may outsource services or products, and such reasons need to be analysed properly before taking this direction.

Some of the advantages of outsourcing / procurement are listed below:

- To reduce or control costs: Your internal staff may not know or not have the capacity to perform certain tasks and therefore, instead of wasting money and time, outsourcing becomes the best option.
- Focus on core business: Most organisations outsource their IT support to specialised IT services companies. That gives them time to focus on their core business and focus on meeting the needs of their clients.

- Cost restructuring: Is a measure that compares fixed costs to variable costs. Outsourcing changes the balance of this ratio by offering a move from fixed to variable costs and also by making variable costs more predictable. For example, you do not need to employ someone to perform certain tasks within your company but you only pay for that service when you need it and you know how much it will cost you.
- Improve quality: You can achieve an improvement in quality through contracting out a service with a new service level agreement.
- Knowledge: By outsourcing, you may gain access to others' intellectual property and wider experience and knowledge.
- Operational expertise: By outsourcing, you access the operational best practice that would be too difficult or time-consuming to develop in-house.
- Access to talent: Outsourcing allows you to access a larger talent pool and a sustainable source of skills, in particular in science and engineering.
- Capacity management: Outsourcing allows an improved method of capacity management of services and technology where the risk in providing the excess capacity is borne by the supplier.
- Catalyst for change: An organisation can use an outsourcing agreement as a catalyst for implementing major changes that cannot be achieved alone. The outsourcer becomes a "change agent" in the process.
- Enhance capacity for innovation: Companies increasingly use external knowledge service providers to supplement limited in-house capacity for product innovation.
- Reduce time to market: Outsourcing allows the acceleration of the development or production of a product through the additional capability brought by the supplier.
- Risk management: An approach to risk management for some types of risks is to partner with an outsourcer who is better able to provide the mitigation.
- BEE score: In South Africa, if you procure your services from a company that scores well on the new BBBEE scorecard it may place you at an advantage to procure business from government departments.

Mistakes and disadvantages of outsourcing are:

- Trying to outsource a business function that has high costs, minimal processes, and is causing considerable management anxiety is a mistake. At least try to take the excess costs out before you outsource. Do not give someone else your savings margin.
- Not developing a business case and strategy on what to outsource, thereby making it difficult to assess costs and process improvement proposals from vendors.
- Not establishing a method of performance measurement upfront during the contract phase.
- Failing to consider the long-term relationship dynamics.
- Not planning upfront how the relationship might end.
- Failing to understand and manage this new organisational dynamic.
- Failure to explicitly define boundaries, with clearly defined roles and responsibilities.
- Never outsource one piece at a time without a master plan.

- Quality risk: In an outsourcing arrangement you may receive a poor quality product or service because of the following reasons:
  - Opportunism by suppliers due to misaligned incentives between buyer and supplier
  - Poor buyer-supplier communication
  - Lack of supplier capabilities / resources / capacity, or buyer-supplier contract enforceability
  - The outsourcer may replace staff with less qualified people or with people with different non-equivalent qualifications

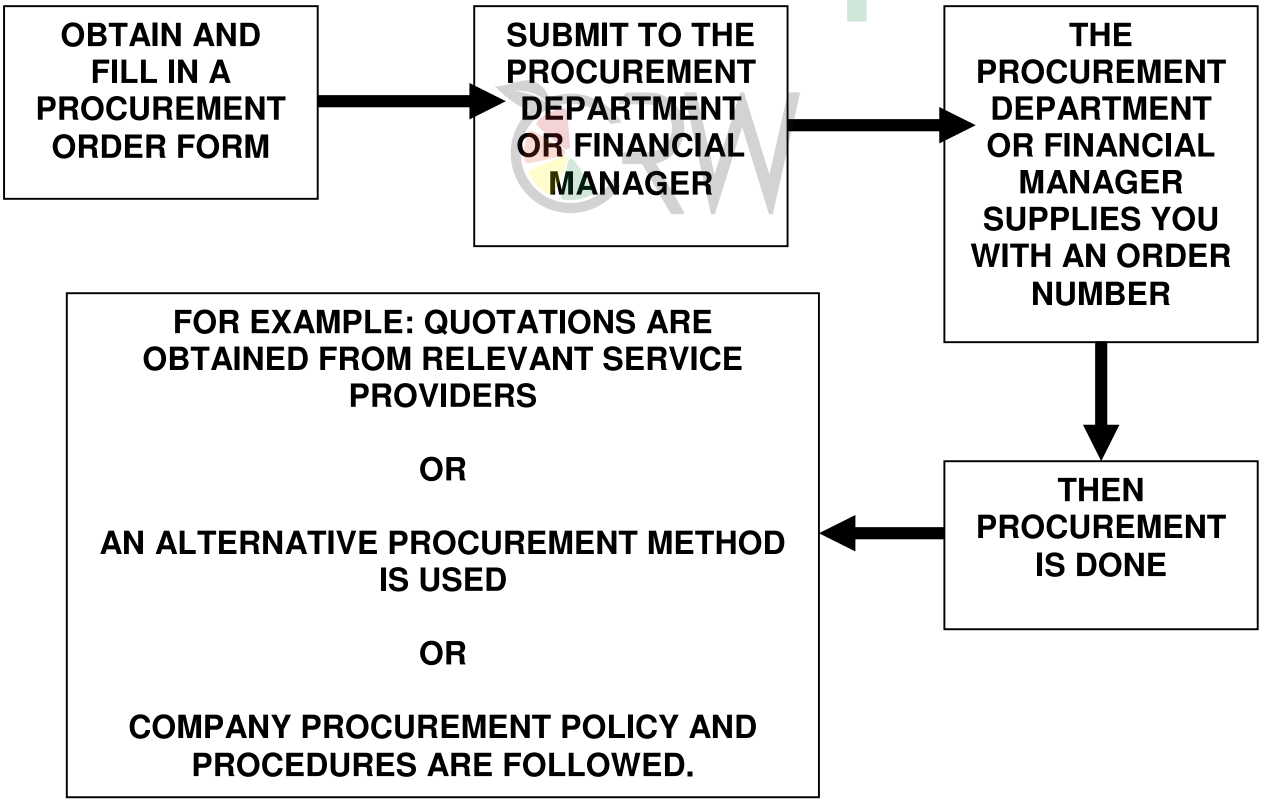
Keep all the above advantages and disadvantages in mind for all your procurement as well as when you provide your services or products to others. Remember, your clients will also consider all the above when deciding to procure from you!

Securing the Budget to Procure the Service

In most companies the permission to procure / outsource services or goods is granted by either of the following people:

- The financial manager
- The whole team
- Business owners
- Supply chain department

The process that is usually followed is:



Using Correct Procedure to Appoint a Service Provider

Several procedures can be followed for procurement or outsourcing. For example, some organisations may use any of the following procedures:

- Purchase order form and purchase order number
- Simple purchase of products or services using a budget-capped (limited) purchase facility (for example petty cash, credit card, or cheque facility)
- Long-term account with product or service provider (such as an accountant or a stationery supplier)
- Tendering

The methods used for sourcing the services or products also differ. The most appropriate methods to source providers are discussed in more detail later in this chapter.

information

What is a tender and what is tendering?

"Tendering" is offering products or services to organisations that are required by law to call for public responses to fill their organisational needs.

A "tender" means a written offer or bid in a prescribed or stipulated form in response to an invitation by an organ of state for the provision of services or goods.

There are two parties involved in tendering:

- The tenderer is the company offering their products and services in response to a call made by the organisation
- An organisation required to call for the tender. This last organisation is referred to as the requester.

Who is required to request tenders?

According to the Preferential Procurement Regulations of 2001, most organs of state are required to request tenders before procuring products or services.

When is a tender necessary?

Organs of State are only required to request for tenders when the estimated cost of the service or product is over a pre-determined amount. With procurement under a certain amount, the organ of state only has to request three quotations.

Unlawful and Negative Methods of Sourcing Providers

- Tenderpreneurship (appointing or sourcing only from providers who have a networking advantage over another provider)
- Nepotism

Determining Supplier Compliance

To ensure that you obtain the most suitable services or products for the needs of your enterprise, you need to ensure that you are clear on what those needs are.

Firstly, the supplier must meet several requirements to be able to do business with your company. For example:

- If one of the values of your company is employment equity and you are a female managed business. You would like to encourage female entrepreneurs, so, through your procurement system, you wish to support and do business with other female managed enterprises. You may thus decide that one of the compliance criteria could be that suppliers who submit quotations / tenders / proposals to you must be owned and operated by women.
- You may decide that you would like to support local businesses and business development. You could thus decide to procure only from local suppliers, and suppliers who have been in business for less than five years.
- Your enterprise would like to assist with the creation of a clean and sustainable environment. You thus prefer to do business with companies that feel the same way and that "walk the talk". You decide to only procure from businesses that can demonstrate an environmental emphasis in their business operations.

It is not illegal to do this. Every entrepreneur has the right to purchase products and services from whom they choose.

Ensuring that you procure products and services from enterprises that share your value system will help reduce the chances of friction, contract breach and conflict between your businesses. We like to do business with people who think as we think.

Also, if you feel strongly enough about a cause (such as the development of women entrepreneurs, or the environment, or job creation), you can encourage development of that issue, by putting the weight of your cash behind others who feel the same. In this way, we can all support and encourage development in those areas that are important to us.

Government departments must procure according to certain rules as well. All government departments must procure according to the Public Finance Management Act.

Although specifics may vary between the level of government and the department, the PFMA encourages BBBEE scorecard compliance and use of local vendors.

Secondly, the supplier must be able to provide you with the particular service or product you need. You will, therefore, need to be very clear on what those requirements are. Failure to do this will lead to unnecessary frustration (for example receiving a lot of calls from providers trying to understand your request).

Let us look at some important aspects of requests for tenders or calls for proposals or database registrations (service provider roster registrations).

Dividing Service Provision into Clusters

The purpose of this section is to assist you to understand the importance of writing your request clearly so that potential service providers can respond appropriately.

Describing the job that needs to be done accurately reduces procurement chaos.

The first step is to break up your procurement need into sections or clusters. For example, let us assume that you wish to purchase corporate stationery. You may need:

- Printed letterheads
- Business cards
- Marketing brochures

There are thus three different "clusters" involved in this purchase.

Most Appropriate Method to Source Providers

One or more of the following methods can be used to identify appropriate service providers. The choice of method depends on the type of service or product procured as well as the type of organisation requiring the product or service (for example government vs. private company):

- Identify relevant service providers in the local phone book or Yellow Pages or by searching on the internet.
- Request quotations from three suppliers known to you.
- Advertise a tender in a local or national newspaper.
- Request proposals (RFP's) from suitable service providers.

Negotiation in Sourcing

Negotiation with contracted service providers is a contentious issue in government departments. The concern arises that if you negotiate with a potential supplier, or change the terms of reference in some way after the bid has been closed, that it may be unfair to the other suppliers who were not given an opportunity to negotiate.

However, negotiation is a matter of course in the private sector. Always negotiate! You will be surprised at how often you will be able to get an added service, more product, or lower prices from a supplier. Do not be ashamed to ask for more "bang for your buck!"

Remember also, negotiating with a supplier is a good way to start a long-term relationship with the supplier. Forming lasting relationships is a means to increase the efficiency with which a service or product is delivered to you, a trusting relationship is formed between the two businesses, and there are always further spin-off business opportunities that will develop through the normal healthy networking inherent in business relationships.

Thus, instead of being only an invoice number to your suppliers, show your face and engage with them. You will be surprised at the results!

Assessing Applications / Tenders

Once you have obtained proposals (or tenders or quotations) from prospective service providers a decision needs to be made that is best for your enterprise.

To simplify this activity a decision-making tool can be used. There are several decision-making tools available (such as flipping a coin!), however, we will discuss the matrix method. This method allows you to decide on criteria that are of importance to you in choosing a supplier.

Those criteria which are of more importance can be allocated a higher score, and can also be weighted to emphasise its importance further. The criteria are solely your personal choice and will differ from one organisation to another. For example, the following decision tool may be used:

Decision-making Matrix

Service Provider	**BEE Score** 90% - 95% = 4 points 70% - 80% = 3 points 50% - 60% = 2 points	**Woman CEO** = 4 points	**Previous jobs** 5 = 5 points	**Price** Cheapest = 4 points	**Total**
Supplier A					
Supplier B					

Remember: It is always best to negotiate the price before making the final decision. Give service providers the opportunity to improve their price and then STOP. A decision must be made (it is difficult to make a decision with "moving targets").

This useful tool can be designed and utilised for any decision that needs to be taken in an enterprise.

Signing the Service Provider

Study the service level agreement (SLA) between Amazing Developments and AgriSETA on the next page.

Working with your facilitator, discuss the meaning of the SLA provided, and answer the following questions:

1. Which of the two organisations is a service provider and which one is requesting the service?
2. Name the services (products) that are being outsourced according to this SLA.
3. How long is the service delivery period?
4. Will amendments be accommodated according to this SLA? If so how?

Service Level Agreement

1. Scope
This Service Level Agreement is between AMAZING DEVELOPMENTS and the AgriSETA. AMAZING DEVELOPMENTS is to provide those services described under point 4. The SLA stays valid from the 1st January 2010 until 1st January 2011.

2. Authorization
Authorization of the Service Level Agreements is the joint responsibility of the following parties:
On behalf of the AgriSETA: Jerry Madiba; CEO
On behalf of AMAZING DEVELOPMENTS: Miss Terry Green

3. Renegotiation
Renegotiation of this agreement will occur if either Amazing Developments or the AgriSETA requires a significant alteration to the agreed service levels as stated within this document.

4. Service Description
4.1 Supply of cleaning sanitation chemicals and tools to AgriSETA Offices for one year.

5. Cost
Payment will be effected upon the delivery of the products as stipulated in point 6.

6. Service Level Agreement Reviews
As a minimum, a Service Level Agreement review meeting will be held every 12 months from the signing of this SLA to either re-sign the current service or renegotiate a changed service. Minor changes can be made provided they are agreed by both parties.

Service	Scheduled start and end dates	Activities and resources required	Total Annual Budget
Supply of cleaning sanitation chemicals and tools to AgriSETA Offices	January 2010 – end January 2011	Supplying appropriate kitchen detergents every month	R80 000.00
		Supplying bathroom detergents and sprays	
		Supplying office cleaning detergents and necessary furniture maintenance material (polish, cloths etc)	
		Supplying entire office cleaning equipment	

Approvals:
Amazing Developments:
Name: Miss Terry Green
Designation: Managing Director
Signature: ______________________________
Date: ___________________________________

Approvals:
AgriSETA:
Name: Jerry Madiba
Designation: CEO
Signature: __________________________________
Date: ____________________________________

Decision of the Appointment Team is Conveyed to all Tenderers in Writing

Make a point of formally informing all service providers who submitted tenders / proposals / quotations, the one that was successful as well as those who were not successful. This is not only polite but also good business practice. Sending letters also to all service providers that were not successful has several advantages:

- You build a reputation as being polite, transparent and efficient.
- You create "top-of-the-mind" awareness. This supplier will remember you next time you call for suppliers and he will think to himself, "I would like to do business with that enterprise!"
- You open the possibility for service providers to improve their offerings. Do not let this confuse you. Keep to your original decision. But, if they ask, inform them which criteria they scored less in, compared to the company that won the bid. State that you have already contracted the winning bidder, but that you will keep them in mind the next time you need the service / product. This will then be the opportunity for them to improve their offering.
- Written letters ensure that no service provider can later state that they were "given the impression" or "told verbally" that they were appointed. This ensures that there is evidence of who you contracted and who you did not.

Remember: A letter is written to all unsuccessful service providers, and a contract or SLA is concluded with the one that was successful.

practical

Complete the following formative assessment:

F119671.1 – Team Simulation and Work Sample Presentation

Chapter 6
Risk Management for Contract Performance Management

Identifying Potential Risks and Developing a Risk Management Plan

Once you have appointed a contractor or service provider, using a contract or service level agreement, you must manage the performance of the contract. This is especially the case when you have entered into a long-term contract with a service provider. However, sometimes it is necessary to manage the risks associated with short-term contracts too.

example

Let us assume that following a search for an appropriate service provider, you found one that promised you the equipment you needed, according to your specifications, at a price that suited your pocket and which promised you delivery within 30 days of paying a 50% deposit.

You have paid a 50% deposit on the invoice that was sent to you and now:

- 30 days have elapsed without delivery!
- At 45 days, the equipment is delivered, but it is not the equipment you specified!
- You receive the final invoice, and the final amount to be paid is R 10 000 more than you agreed!

Looking back at your transaction, what were the three things that could have gone wrong with this purchase?

1. The equipment could be incorrect once delivered
2. The delivery could be delayed
3. The price could be more than agreed

Before any purchase is made, or contract entered into, the risks associated with that purchase or contract should be identified and measures put in place to mitigate that risk.

Some potential risks of the above-mentioned transaction could be:

- The vehicle delivering the equipment is involved in an accident and the equipment is custom-made and you have already paid for it.
- When the service provider installs the equipment, one of their workers is injured during the installation on your premises.
- The equipment is installed (at the price, specification and on time), and the next day your factory is burgled and the equipment stolen.

Mitigating Risk

- What additional points can be specified in your contract to ensure that these risks are mitigated?
- What additional steps should you take within your enterprise to mitigate these risks?

Updating the Contracting Process

During the contracting period, there is usually a need for communication between supplier and client. Communication may be required to change the terms of reference or to check progress towards the delivery of the service or product. An SLA or service level agreement (also sometimes known as a contract or MOU - memorandum of understanding) usually states clearly the kind of communication and reporting needed by both parties. For example, depending on the kind of service delivery agreement, two or more of the following communication methods may be applicable:

- Reports (monthly, quarterly, bi-annually or annually)
- Payment certificates (submitted by the service provider for job done)
- Invoices (with detailed items which the service provider is claiming for)
- Minutes of meetings (for example project committee meeting or stakeholders meetings.)

These communication methods must be agreed to by both parties, usually in writing.

Measuring Contract Progress Reports against Performance Requirements

For longer-term contracts, it is important to ensure that the service you required is being delivered on an on-going basis. A good way to measure the performance of a long-term contract is to request (already at contracting stage) interim reports.

An interim report can include information such as:

- A detailed schedule of the work to be performed (an action plan)
- A detailed analysis of the work done
- A detailed analysis of any deviations from the action plan, why these deviations occurred and how these deviations will be remedied for the remainder of the contract
- A detailed analysis of the cash flow on the contract
- An updated action plan for the way forward

Conducting Surveillance of Risk Areas

If there are deviations to the agreed action plan, both parties must agree to the actions that will be taken to remedy those deviations. This agreement can be added to the original contract as an addendum. But, both parties must agree to the changes in the action plan.

practical

Complete the following formative assessment:

F119671.2 – Team Discussions, Frameworks and Key Notes

Chapter 7
Handling Contractual Changes and Disputes

Identifying Contract Terms and Conditions

Specific Contracts

Apart from the above general requirements of contracts (such as reporting requirements, risk mitigation procedures, allowance for amendments), there are specific requirements for different types of contracts.

A contract for purchasing an object differs from a contract for hiring movables because the specific requirements known as the "essentials of contract types" differs. An entrepreneur should have a basic knowledge of certain contracts, therefore the more general types of contracts are discussed.

Contract to Purchase

A purchase agreement may be defined as an agreement where someone acquires property as his exclusive asset from another by paying the price. Apart from the general requirements for a contract to be legally binding, the parties must also agree on the following:

- Both parties must have the intention to conclude a contract for the purchase
- The subject / identity of the property sold
- The purchase price

The subject for sale may be movables, such as a light delivery van, or immovable such as the business stand or even incorporeal things such as debtors. Not only one's property but also the property of a third person may validly be sold as long as the seller at the time of delivery provides the free and undisturbed use of the property as well as all the rights pertaining to the property.

The purchase price must be certain or readily ascertainable, must be expressed in terms of money or else it will be an exchange. Written documents are sometimes required by law, for example when purchasing immovable property and in the case of a company and a close corporation (CC), pre-incorporation contract. Non-adherence renders the contract void. Unless agreed otherwise, it is assumed that the price will be paid in only one instalment (cash sale). Nothing prevents the parties from agreeing that the price will be paid in two instalments. The buyer becomes the owner at the time of delivery of the object.

Lease Contracts

A lease agreement may be defined as an agreement whereby someone acquires the use and enjoyment of property for a determined period of time against the payment of a sum of money. As a general rule, there are no formalities required by statute or the common law, except that the parties must have consensus about the following:

- The property to be let must be certain or ascertainable
- Both parties must have the intention to conclude a contract or lease
- The amount of the rent

The lessor guarantees the use and enjoyment of the property. Disturbance thereof constitutes a breach of the contract. Nothing prevents the lessee from sub-leasing the property to a third party unless otherwise agreed to. The lessor does not become a party to the sub-lease agreement and is not affected by any term thereof. The original lessee remains personally liable for the payment of the rent to the lessor. If the property is sold by the lessor, the lessee's rights remain intact.

Credit Agreements

A credit agreement is a credit transaction which includes a contract in terms whereof property is sold and the whole or part of the purchase price is payable by instalments. In the case of an instalment sale agreement, the buyer becomes the owner of the property when the whole of the purchase price has been paid. In the meanwhile, the buyer obtains the use and the enjoyment of the property.

All credit agreements must be in writing and signed by or on behalf of each party. The following information must be included in the contract:

- The full particulars and addresses of the parties
- The deposit
- Particulars of the property bought, as well as the particulars of the trade-ins
- The condition regarding passing ownership (only in case of instalment sale agreement)
- Particulars of the seller's right of restoration of the property
- Particulars of the cooling-off period

A buyer has the right to cancel any credit agreement that falls within the act without a reason if the contract was not concluded on the seller's premises and the initiative came from the seller, for example, contracts concluded by a door-to-door salesman.

Rules To Remember When Contracting

Some basic rules should be kept in mind when entering into any contract. They include:

- Get it in writing. A verbal agreement, or "handshake deal", is just as much a contract as one that is written down. The difference lies in proving the terms. Because memories dim over time, or there can be outright dishonesty by parties, written agreements provide better evidence of what was intended.
- This does not mean that every written contract must be signed as-is. Be particularly careful when handed a "standard form contract", with a statement that no changes can be made. Simply because it is professionally typeset and looks intimidating does not mean that it cannot be amended. Remember also

that one can simply walk away if the contract terms are too severe. In some cases, there may not be many alternatives, but consider whether the consequences are just too harsh to accept.

- Ensure accuracy. Read the contract carefully to be sure it matches what has been promised. If something is missing, or requires clarification, have it included or amended before signing.
- Consult experts when necessary. If parts of the contract are confusing, contact a lawyer or other person who can provide independent advice. Even where the language seems straightforward, a review can point out risks, which may not be obvious, and can save thousands of Rands.
- Keep the channels of communication open. If problems arise during a contract's term, talk to the other party as soon as possible to try and find a solution. Whether it is due to embarrassment or anger, it is often human nature to avoid talking to the other side when difficulties occur. It is remarkable how many problems can be solved or kept from escalating just by communicating and working through the issue.

Breach

In any contract, the action that may be taken if either party does not comply with the contract specifications is defined by the "breach" clause. Two examples of "breach" clauses are shown below:

- In the event of any party being in breach of a provision of this agreement, all of which are deemed to be material, the aggrieved party may require the defaulting party to remedy such breach within 21 (twenty one) days, and may in addition to any other remedies available to it in law, terminate this agreement summarily.
- If either party breaches this agreement, the aggrieved party may give written notice to the defaulting party to rectify the breach within seven (7) days. If the breach is not rectified the aggrieved party may cancel the agreement and recover any damages suffered as a result of the breach.

Ensure that any contract you undertake contains such a breach clause. This is one way that you can ensure that you have redress if things should go wrong. For example, a service provider does not deliver the required quality or quantity of goods, or a service provider does not deliver the items on time, or, if you are the service provider, the client does not pay you for your services or products on time or does not pay the correct amount.

Implementing Change and Dispute Processes

If a party to a contract is in breach and is informed by the other party of this, then the two parties need to get together and resolve the issue. This may require re-negotiation of the contract stipulations and an agreement to change the contract. If changes are agreed then both parties must sign an agreement to the changes. If the re-negotiation process fails it may be necessary to go for arbitration.

Arbitration requires a third party to mediate the dispute. Such an arbiter must be a person agreed to by both parties and must be someone who is neutral to the contract. Generally, lawyers are called on to serve as arbiters or mediators to a dispute.

Whatever agreement is reached through this process must be captured in writing. This could be the minutes of the meeting, but should also be captured in writing and amended to the original contract. Both parties must sign these minutes or contract amendments.

practical

Complete the following formative assessment:

F119671.3 – Team Role-play and Key Notes

Chapter 8
Compliance and Administrative Close-out of Contracts

Evaluating Work and Performance Results

If contract management has been done effectively, the performance of the supplier to deliver to the contract specifications will meet the needs of the client. As mentioned previously this performance can be measured using any one of these tools:

- Reports (monthly, quarterly, bi-annually, or annually)
- Payment certificates (submitted by the service provider for job done)
- Invoices (with detailed items which the service provider is claiming for)
- Minutes of meetings (for example project committee meeting or stakeholders meetings)

If both parties deliver to the specifications of the contract, the contract can be concluded and closed out.

Understanding Contract Terms Relating to Contract Termination

There are various reasons why a contract could be terminated. Obviously, the main reason would be when the service or product has been delivered to specification and both parties agree that the contract is now concluded.

Reasons for terminating a contract before the service or product has satisfactorily been delivered could be:

- When both parties agree to terminate the contract for whatever reason that they both agree to
- When the client fails to make the initial or full payment for the agreed product or service
- Either one of the parties failing to fulfil any of the obligations undertaken by them and failing to remedy the breach within a set period as agreed by both parties, after receiving written notification demanding that the breach be rectified.

Conducting a Basic Audit

Some clients may require that a thorough audit of the contract and the successful delivery of the product or service be conducted.

Such an audit could be conducted by an auditor or an accountant either appointed by the service provider or the client. It is the responsibility of the service provider to provide the auditor or accountant with all the information they require to complete the audit. Withholding any information would not be in the best interests of the service provider – especially if a final payment depends on such an audit.

An audit may require the provision of the following information:

- A copy of the contract document, along with the terms of reference, action plan and any amendments made to the contract during the contract period.
- A copy of the financials on the appointment / contract. This may be bank statements, invoices (both invoices to subcontractors or service providers and invoices made out to the client during the contract), proofs of payments and delivery notes.
- Specifications for the product or service delivered and proof that the service or product complies with these specifications. This may relate to the quantities or quality of the service or product that was delivered. For example, if you said you were going to build a house of $150m^{2,}$ the auditor may wish to measure the house to ensure that that is actually the size of the house built.
- Copies of all correspondence relating to the contract. This may include letters, emails, faxes, tenders, sub-contracts and reports related to the contract.

The auditor or accountant will request some or all of the documents above. They may require a specific invoice and its proof of payment and compare these to the bank statements to see whether the transaction actually took place.

At the end of the audit, the auditor or accountant may bring discrepancies to the attention of the service provider or client and allow these discrepancies to be explained or remedied.

A final report is then submitted to the client which verifies that the contract specifications were complied with or not.

Signing off Contracts and Final Administrative Procedures

Not all contracts require a final audit. However, some final administration may be required before the client agrees to pay the final invoice. This administration may include providing the client with the guarantees or warranties related to the service or product delivered, or it may take the form of a final report.

Whatever these requirements are, they should have been captured in the initial contract, so that both parties were clear from the outset what would be expected of them to close out the contract.

When the final administrative issues have been concluded, the product or service has been signed off as delivered to the client in good condition (or to the required quality), and the final invoice paid, the contract is then terminated or closed.

practical

Complete the following formative assessment:

F119671.4 – Team Role-play and Meeting Minutes

Section 2: Self-Assessment and Progress Check

Understand and explain contract administration principles and techniques.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Obtain and analyse performance requirement of contract.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Obtain and interpret a contract document in agribusiness.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Analyse a contract document and draw up a basic contract administration plan to ensure effective contracts management.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Evaluate the risks of non-compliance against performance requirements of the business.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Draw up a basic risk management plan to avoid non-compliance problems.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Apply basic risk management techniques in managing performance.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Implement the risk management plan related to the contract in line with the contractual requirements.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Identify and quantify common risk areas against the contract performance requirements and the original risk management plan.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Obtain contract progress reports and measure them against the performance requirements and the risk management plan.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Conduct surveillance of risk areas and take appropriate corrective action to avoid negative risk.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Demonstrate an understanding of contract changes and disputes.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Identify and understand contract terms and conditions related to changes and disputes in order to manage the contract effectively.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Implement change and dispute processes where relevant.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Negotiate and document changes and disputes in order to proactively address potential areas of dispute.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Seek external advice where necessary in order to resolve disputes and ensure that negative business risk is avoided.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Ensure compliance and administrative close-out of contract.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Evaluate work and performance results against contract deliverables and establish whether work is completed effectively.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Understand and implement terms related to contract termination according to contractual requirements.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Conduct a basic audit to ensure that all parties have complied with their contractual obligations.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Sign off and finalise administrative procedures to ensure closure of the contract.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment