NATIONAL QUALIFICATIONS CURRICULUM SUPPORT

Business Management

Business Decision Areas II: Financial Management *and* Human Resource Management

Revised Student Notes

[INTERMEDIATE 2]

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Acknowledgements

Learning and Teaching Scotland gratefully acknowledge this contribution to the National Qualifications support programme for Business Management. The original resource of this title was published by HSDU in Spring 2001. This revised version was updated by Mark Kinnon.

The Revised Student Activities that accompany these Revised Student Notes are available separately.

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Introduction

This pack contains student notes to support the learning and teaching process for part of Business Management (Int 2). It covers material from Outcome 1 of the Business Decision Areas: Finance and Human Resource Management (Int 2) unit of the course and relates to the following areas of the course content:

- **Financial Management**
  The role of the finance function
  Financial information
  Uses of financial information
  Users of financial information

- **Human Resources**
  Human resource management
  Recruitment and selection
  Training and development
  Employee relations
  Legislative requirements

About this pack

The pack consists of student notes which are intended as a 'core text' for students and provide the basic material for Business Management at Intermediate 2. Students who have assimilated this material should have the requisite knowledge to enable them to achieve a satisfactory level of performance in this area of the course. However, depending on the capabilities of a particular group, teachers and lecturers may wish to provide additional material to help students achieve as high a grade of pass as possible.

In general, the student notes have been organised in a way that matches the order of the course content as set out in the Arrangements for Business Management (Int 2). This coincides with other material for the course such as the Course Planner and the Student Activities for Intermediate 2.

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Using this pack

The student notes can be used in a number of ways, depending on teacher/lecturer preference. They can be given out as handouts which students may read in class or as homework. This may be at the beginning of a topic or to consolidate learning once a topic has been completed. The notes are complementary to the Student Activities for Business Management at Intermediate 2 and could be used in conjunction with them.

This pack is designed to stand alone but it is also complementary to the student notes at Higher level. In this case, the relevant sections are Business Decision Areas (H): Financial Management, and Business Decision Areas (H): Human Resource Management. As far as possible, given the differences in the course content between the two levels, the format of this pack matches the layout of the pack at Higher level. This should help teachers and lecturers who are required to deal with a bi-level group and students who move from one level to another.

In using the pack, students should be encouraged to relate the material to any experience they may have of business and to developments the local and national business environment. This can help to illustrate and exemplify the material in the student notes as well as helping to keep it current and up to date.

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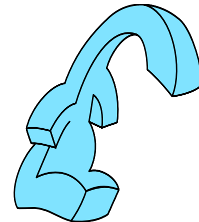
Section 1: Financial Management

The role of the finance function

Finance is important to every organisation, because all organisations have to deal with money. However, different types of organisations have different financial objectives. Companies in the private sector like Vodafone have financial objectives to do with maximising profit. Charities may have the financial objective of getting as many donations as possible. They may also aim to use their funds as effectively as they can so that they can help as many people as possible. Clubs may wish to use the funds they have as efficiently as they can so that they can give the best possible service to their members.

All these different types of organisations share the need to have good financial management. Every organisation must manage its finances efficiently to ensure the success of its business – whatever this is. For example, every organisation must make sure that it:

- has enough money to pay the wages and salaries of its employees
- has enough money to pay its bills – for things like supplies of raw materials, electricity, advertising and so on
- has enough money to develop new products to avoid being overtaken by competitors
- checks how much it is spending – organisations, which have high costs, are often unsuccessful.



The **finance department** is responsible for the financial affairs of the organisation. Its role is to manage the finances of the organisation and to make sure that the organisation meets its financial objectives. It has three main tasks:

Payment of wages and salaries

This means making sure that all employees are paid the right amount at the right time. The finance department must make sure that all deductions for tax, National Insurance, etc. are made properly. They must also provide information for the Inland Revenue to make sure that taxes have been paid and have been correctly calculated.

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Payment of accounts

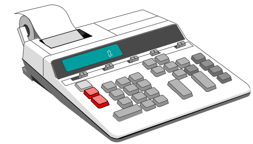
This covers both making payments (e.g. to suppliers) and collecting amounts owed to the firm from customers. Part of the role of the finance department is to make sure that there is enough cash available for the organisation to pay all its bills. The finance department also collects information about costs and has a role to play in controlling costs.

Maintenance of financial records and accounts

This includes recording financial transactions and preparing final accounts. All organisations are required by law to provide some financial information. The financial records enable the finance department to provide a financial summary of the business.

These tasks overlap with each other. For example, the finance department must make sure there is enough cash to pay wages as well as suppliers. Controlling costs requires that financial records of costs be maintained. The finance department must communicate the information that it collects to managers. They can then make decisions based on what the finance department tells them.

Overall, the accounts show how the business is doing by recording:



- how it has spent its money
- the income it has received from sales
- the value of its assets (i.e. equipment, buildings, cash, etc)

Most organisations employ accountants who are financial specialists. Some small organisations like sole traders do not employ an accountant directly but they do buy in the services of an accountant. The job of an accountant in an organisation is to use the information from the accounts to answer questions such as:

- How is the company performing?
- Have we done better than last year?
- How much tax will we have to pay?
- Can we afford to expand or buy new equipment?

The rest of this section looks at the following:

1. The ways in which organisations **present financial information** – this covers cash flow statements, final accounts (i.e. the trading and profit and loss account and the balance sheet) and ratios.

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2. The **uses of financial information** – this deals with the things that organisations use financial information for.

3. The **users of financial information** – financial information is used by stakeholders such as the owners of the company, the people to whom the company owes money, the Inland Revenue (who will collect tax due), the Customs and Excise (who will collect VAT due).

Financial information

Cash flow statement

In every organisation money comes in and goes out. Businesses have to decide how they can manage **receipts** and **payments** so that there is always enough cash to pay the bills of the business or to buy assets for the business. Organisations may also need to know whether they will have to borrow money to make payments.

A cash flow statement:

- shows, usually on a monthly basis, how much cash the organisation has available
- shows what money came in during the period
- shows what money went out during the period
- alerts the business to any cash flow problems
- is used to help make decisions
- can be used to forecast whether a loan or overdraft may be necessary.

A cash flow statement calculates the amount of money the firm has available at the end of each month. It begins with the opening balance. This is the amount available to the business at the start of the month. The next step is to add the receipts for the month to the opening balance. Payments made by the firm are then taken away. This gives the closing balance. This is the amount of money left at the end of the month.

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The following example explains and illustrates a cash flow statement.

The information is for Les King, a sole trader. It applies to his first three months of trading.

Before we can do a cash flow statement, we need some background information about Les's business. Les started up his business with £500 savings and he estimates his **receipts** for the next three months to be as follows:

June	Start up grant	£1,500
July	Cash Sales	£1,600
August	Cash Sales	£1,400

His monthly **payments** are as follows:

Rent	£300
Telephone	£40
Advertising	£100
Electricity	£100
Wages	£250

He also has to buy stock as follows:

June	£800
July	£700
August	£700

The figures have been used to produce the cash flow statement below for Les's first three months of trading. To find out whether the business has enough money to continue, the following calculation is made:

The **opening balance** is the amount of money in the bank or in cash in the business at the start of the month.

This is added to the **total receipts** – the money that has been received into the business – for example, from selling goods. This gives the total cash available for that month.

Then, the **total payments** – any amounts that have been paid out of the business – are taken away from the total cash available.

This gives the **closing balance –** the amount of money left in the business at the end of the months trading.

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The closing balance at the end of one month is the opening balance for the next month.

This is shown in the cash flow statement below:

Cash flow statement for Les King – June–August

	June	**July**	**August**
RECEIPTS			
Grant	£1,500		
Sales		£1,600	£1,400
TOTAL RECEIPTS	£1,500	£1,600	£1,400
PAYMENTS			
Rent	£300	£300	£300
Telephone	£40	£40	£40
Advertising	£100	£100	£100
Electricity	£100	£100	£100
Wages	£250	£250	£250
Purchases of stock for resale	£800	£700	£700
TOTAL PAYMENTS	£1,590	£1,490	£1,490
Opening Balance	£500	£410	£520
Add Total Receipts	£1,500	£1,600	£1,400
	£2,000	£2,010	£1,920
Less Total Payments	£1,590	£1,490	£1,490
Closing Balance	£410	£520	£430

In June, Les had £500 available in the bank at the start of the month. He also received a total of £1,500 during the month, as he received a grant. This meant he had a total of £2,000 available to spend on the business. During the month he spent a total of £1,590 on rent, telephone, advertising, electricity, wages and stock. This left him with a total of £410 at the end of the month. This, therefore, was the opening balance he had available at the start of July.

Les can use the cash flow statement to find out if the business will have enough money to do what he plans. He can find out from it whether he will have to look for additional forms of finance to help him continue in business.

Decisions that Les takes in the business can affect his ability to pay his bills. For instance, suppose Les decides in August that he wants to buy a computer for the business. The total cost will be £2,000. By examining his cash flow statement we can see that he only has £430 left. Les has not got enough cash

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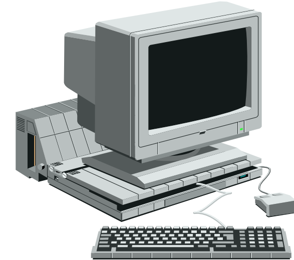
to buy the computer. Therefore, to ensure his business does not get into cash flow problems, he could consider:



- **leasing the computer** – this would mean that he would pay monthly amounts to a leasing company to use the computer. However, he would not own the computer and at the end of the leasing period, it would have to be returned to the leasing company.
- **getting a loan for the computer** – Les could get the computer straight away instead of saving for it, by applying for a loan. However, interest would have to be paid to the bank or another lender in addition to the repayments for the loan.

- **buying the computer on hire purchase** – again Les could get the computer straight away, but usually he would have to pay interest along with the monthly repayments.

A cash flow statement can therefore be used to help the decision making process in businesses. It shows whether there is enough money for the business to do what it plans. It can also show whether a business needs to find cash from somewhere else. It can help business answer questions such as:

- **Do I need to arrange an overdraft/loan?**
- **Do I have enough money to buy a new piece of equipment?**

Cash flow problems

Cash flow problems can arise even if the firm is successful in selling a lot of its goods. If goods are being sold on credit, customers do not pay for them straight away. This can lead to cash flow problems, as the company is having to pay for their stock and overheads like heat, light, petrol, rent and wages before their customers are paying for the goods.

It is therefore vital that cash flow is well controlled to make sure a business is successful. The following points should be noted:

- Timing of flows of cash into and out of a firm is crucial. This is as important as the total amount of cash generated.
- Companies don’t go bankrupt because they lose money, they go bankrupt because they run out of money.

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- Companies that make sure that they always have enough cash available for their needs are more likely to be successful.

Methods of improving cash flow

There are many ways in which organisations can improve their cash flow. Some of these include:

- raising extra capital by re-investing profits, issuing shares, or by the owner investing more funds. By doing this, the organisation will get an inflow of cash.
- taking out loans – from a bank or other financial institution. Small organisations can get a loan from friends or partners. By doing this, the organisation will get an inflow of cash but repayments (including interest) will have to be made regularly.
- tight credit control – this means that the firm should ensure that it collects the money owed by debtors (people who owe the firm money) as quickly as possible. This will improve the inflow of money but may cause bad feelings with customers who may leave and go to other suppliers.
- sale and lease back – selling fixed assets to a leasing company to raise money and then leasing them back. This will provide an inflow of cash but there will be regular payments to the leasing company.
- spreading purchase costs – hire purchase or leasing. This will mean that the outflow of cash will not be in one month but will be spread over a number of months.
- tight stock control – ensuring capital is not tied up in too much stock. This will help to keep the outflow of cash to a reasonable level.
- checking customers' credit worthiness before goods are sent out – this will ensure that customers are reliable and will pay their bills. This, in turn, means that the inflow of cash is kept up.

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Final accounts

There are a number of stages involved in putting together an accounting system:

- Preparing and recording accounting documents
- Transferring the information from documents to records in books or on computer
- Preparing financial statements.

Amounts are transferred from bills and other accounting documents to ledgers. The totals from these are then used to prepare final accounts.

Financial records must be kept to:

- keep a secure record of all transactions to prevent fraud
- produce accounts for tax purposes
- monitor business performance so that managers and owners can see how well the firm is doing.

Businesses prepare final accounts to provide a financial summary of all trading activities during the year. The final accounts are the Trading, Profit and Loss Account and the Balance Sheet.

The following sections give some examples of final accounts.

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The Trading and Profit and Loss Account

This can be split up into the Trading Account and the Profit and Loss Account. The Trading Account shows the **gross profit** (or loss) for a business. The gross profit is the **sales revenue** minus the **costs of the goods.** So, the trading account shows how much money has been spent on buying stock and how much money was made when the stock was sold. In other words, the trading account shows the profit, before charging any expenses or overheads like heat, light, wages or telephone bills. This account allows the owner to see how healthy the profit is before these expenses are included.

An example of a Trading Account is shown below.

D Bloom's Trading Account for year ending 31 December

	£	£
Sales		3,000
Stock at start	1,000	
Add Purchases	2,150	
	_____	
Goods available for sale	3,150	
Less Stock at end	1,950	
	_____	
Cost of Goods Sold		1,200
		_____
GROSS PROFIT		**£1,800**
		_____

The **opening stock** is the stock left over from last year, which can be sold this year. The opening stock is added to any **purchases** of stock this year. This gives the stock the business has available to sell during the year. The **closing stock** is any stock left at the end of the year. This is taken away from the stock available to give the cost of the goods, which the business has sold during the year. This **cost of goods sold** is then taken away from the **sales revenue** (i.e. the money made from selling the goods to customers). This gives the **gross profit** made during the year. Businesses don't always make profits so this could be a gross loss in some cases.

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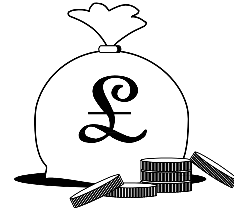
The Profit and Loss Account



The Profit and Loss Account is completed after the Trading Account. It shows the **net profit**. It includes all expenses and overheads like heating, lighting, wages, telephone bills, etc.

Net profit is gross profit minus all expenses and overheads. The Profit and Loss Account shows how expenses affect the final or net profit that the business makes during the year.

The Profit and Loss Account starts with the **gross profit.** Any additional **income** (or **revenue**) that the business has got is **added** to this. This additional revenue could come from things like discounts or from selling items that the business owns.

Then the **expenses** involved in running the business are **deducted**. This gives the **net profit** (or loss).

An example of a Profit and Loss Account is shown below:

D Bloom Profit and Loss Account for year ending 31 December

		£	£
Gross Profit			1,800
Less	Expenses		
	Telephone	100	
	Rent	150	
	Wages	175	
	Electricity	200	625
NET PROFIT			**£1,375**

The Profit and Loss Account shows how profitable a business has been over a period of time.

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The Balance Sheet

The Balance Sheet is a statement showing all the **assets** of a business (what it owns) and the **liabilities** of a business (what it owes) at a particular point in time.
An example of a Balance Sheet is shown below:

D Bloom Balance Sheet as at 31 December		
	£	£
Fixed Assets		
Premises		20,000
Computer		2,000
		22,000
Current Assets		
Stock	1,950	
Debtors	3,551	
Cash	3,400	
	8,901	
Current Liabilities		
Creditors	1,586	
Working Capital		7,315
Net Assets		**£29,315**
Financed by		
Capital at start	27,940.00	
Add Net Profit	1,375.00	**£29,315**

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The Balance Sheet shows all **assets** belonging to the company **minus all liabilities** of the company at a particular time. It also shows how the company has been financed. **Assets** can be:

- **fixed** – these are long term assets. They are owned for a long period of time e.g. premises, equipment, vehicles, tools or
- **current -** items owned that are constantly changing like the firm's bank account, cash in the till, stock of goods for sale or debtors (customers who owe the firm money).

Liabilities can be:

- **long term –** owned for a long period of time, like, for example bank loans. Money invested in the business by the owner is known as **capital**.
- **current** – owed for a short period of time to suppliers (creditors), the bank or for bills due to be paid or.

The final accounts shown are for a **sole trader**, a person in business on their own. Capital is the amount of money invested in the business by the owner and his/her financial backers. In other types of business – like a partnership or a limited – company more people invest in the business. The balance sheet for these other types of organisation will show the different forms of finance e.g. the amount paid into the company by shareholders.

Ratios

The financial information obtained by an organisation can be used to calculate ratios. Using ratios can help managers and owners make decisions for the business and compare their business with other ones. Ratios can be calculated for three areas of a business.

- **Profitability** – profitability ratios show how profitable a firm is.
- **Liquidity** – this means how much cash a firm has. The most liquid asset a firm can have is cash itself. Some other assets can easily be changed into cash (e.g. stocks of finished goods can be sold). They are called near cash. Liquidity ratios show how much cash or near cash a firm has. They can tell a firm whether or not it has enough cash to pay its bills.
- **Efficiency** – efficiency ratios show how effectively a firm is working.

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Profitability Ratios

The three profitability ratios we are going to consider are the **Gross Profit Percentage**, the **Net Profit Percentage** and the **Return on Capital Employed**.

Gross Profit Percentage

The gross profit ratio relates gross profit to sales revenue:

$$\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Sales Revenue}} \times 100$$

Example

Sales Revenue £100,000

Gross Profit £30,000

Gross Profit Percentage = **30%**

A percentage of 30 per cent means that for every £1 of sales a 30p gross profit is made. This profit is fine as long as the expenses or overheads are not too high.

The gross profit percentage ratio should be calculated regularly and any change should be investigated. If the ratio falls it may just be because the price of goods bought has gone up, however, it may reveal that there have been goods stolen from the business.

Net Profit Percentage

This ratio is calculated from the profit and loss account and relates net profit to sales revenue.

$$\text{Net Profit Percentage} = \frac{\text{Net Profit}}{\text{Sales Revenue}} \times 100$$

Example

Sales Revenue £100,000

Net Profit £10,000

Net Profit Percentage = **10%**

The net profit ratio takes into account any changes in business expenses. For example, if the gross profit percentage is the same as last year but the net

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profit percentage is lower than last year, it may mean that expenses have increased. Managers may then have to try to control expenses, for example, limit phone calls and use e-mail instead, or switch off lights or heaters when they are not in use.

As firms are interested in making profits, the higher the net profit percentage ratio the better. It is useful also to compare this ratio to the percentages made by other firms in the same type of business. This helps managers to see if the business is doing as well as it could be.

Return on Capital Employed

This ratio compares net profit to the amount of capital invested in the business. When owners invest money in a business they will be expecting their investment to make money. In other words, they will be looking for a return on their investment. This ratio shows the return that the owners of the capital have got on their investment. The higher the return, the better for the owner or owners.

$$\text{Percentage Return on Capital Employed} = \frac{\text{Net Profit}}{\text{Capital Employed}} \times 100$$

The figure for capital is usually taken at the beginning of the year, as this is the capital being used to earn the profit for the following year.

Example

Capital at start of year	£50,000
Net Profit for year	£10,000
Return on Capital	**20%**

The return should be compared to previous years, and to that made by other similar businesses. However, the return should also be compared to returns which could be made if the same sum of money was invested elsewhere. It could, for instance, have been put in a bank or building society or in shares of another company.

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Liquidity Ratios

Liquidity is the term used to work out how quickly an organisation can convert its assets into cash in order to meet its debts. There are two main types of Liquidity ratios – the **Working Capital Ratio** and the **Acid Test Ratio**.

Working Capital Ratio
This compares current assets to current liabilities.

Example
Working Capital Ratio

Current Assets:Current Liabilities

5,000:2,500 = 2:1

The ideal working capital ratio is 2:1. This means that a business will have enough cash (or near cash) to pay off all its debts and still continue in business. The working capital ratio is important to every business. If the ratio is allowed to fall, then the business may not be able to pay its creditors if they ask for their money. If this happens, no matter how high the profit ratios are, the business can still become bankrupt

Acid Test/Quick Ratio
This ratio is similar to the working capital ratio except that stock is removed from the equation. The reason for this is that there is no guarantee that stock would actually be sold so it may not be a liquid asset. Even if stock is sold, the cash is not always available instantly or the items may have to be sold at a cut price. If this is the case the firm will get less cash than the true value of the stocks.

Example
Acid Test Ratio

Current Assets – Stock: Current Liabilities

2,500:2,500 = 1:1

In order for a business to survive it must have enough working capital to pay for its day-to-day bills. A 1:1 ratio is ideal as it illustrates the fact that the assets will cover the current liabilities if necessary.

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Efficiency Ratios

Rate of Stock Turnover

This ratio shows how long the business is holding on to stock. Ideally firms do not want stock to stay in the business too long. Stock turnover is the average time an item of stock is kept in the business before selling it.

The formula for rate of stock turnover is $\frac{\text{Cost of Goods Sold}}{\text{Average Stock*}}$

*(opening stock + closing stock)/2

35,000/7,000 = 5 times

This means that the organisation buys and sells the whole value of their stock on average five times during the year. There is no ideal figure since a furniture dealer may well only buy and sell stock three/four times a year whilst a grocer may buy and sell daily or weekly. If the grocer has a stock turnover of 52 times a year, for example, this means that every week the grocer would have bought and sold his or her complete stock.

Purposes of ratio analysis

Managers and others use ratios to interpret the **profitability**, **liquidity** and **efficiency** of the business. This a process commonly referred to as **ratio analysis**.

Uses of Ratio Analysis

- to compare the current year's performance with that of previous years
- to compare the performance of the organisation with that of similar organisations
- to identify why differences occur and how to best to improve performance in the future
- to use the information for forecasting/budgeting
- to assist in the decision making process.

Limitations of ratio analysis

- Ratio analysis only covers financial information. It does not take into account any other factors such as the quality of staff or the location of the business. These may have a big influence on the performance of a business.
- Ratio analysis does not take into account general business conditions such as inflation, and interest rates which affect the firm and the economic environment.
- Ratio analysis can only be used to compare similar companies ie those of a similar size and in the same type of business.

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Uses of financial information in business

Financial information is used for a wide variety of purposes by different stakeholders of the business.

Controlling costs and expenditure

Managers and owners can use profitability ratios to investigate and decide which costs should be monitored and dealt with. These ratios can also be used to decide whether suitable prices are being charged for the items of stock. If the ratios are too low, the prices can be raised. However, this may lead to customers going elsewhere.

Managers and owners can also use the profitability ratios to decide whether the profits are high enough to reward workers by giving them bonuses at the end of the year.

Forecasting trends and planning for the future

Businesses can use ratios to forecast trends from year to year. They can see which areas of the business are affecting profits, e.g. cost of purchases, administrative costs, wages, or revenue earned for sales.

Managers can use cash flow to forecast trends. This helps them to identify whether:

- proposed increased wage costs would lead to them having to arrange an overdraft
- the proposed purchase of a computer would mean having to arrange a loan.

Financial information about the business along with information collected on competitors can be used to consider introducing something new. This could be new products or new methods of production or selling, for example, on the internet.

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Users of financial information

Managers can use final accounts and ratios to monitor performance by comparing profits from year to year, or with other similar organisations. They can also ensure that targets and objectives such as sales levels, profitability and production levels are being met.

However, they are not the only stakeholders who will use financial information to assess the performance of the business. The table below outlines how various stakeholders will use financial information.

Users of financial information	Value of information to the user
managing director	helps them to monitor profitability of the organisation helps in the decision making process when making future plans useful for control purposes.
other managers	helps them to prepare forecasts, budget, work out profitability of departments – i.e. manage efficiently.
shareholders	lets them know amount of profit helps them check on liquidity helps them check on the overall success of the business
creditors	highlights trends in sales and profits, and the ability of the organisation to pay debts
employees	reassures them that there is job security (or not, as the case may be!) highlights whether wage rises and bonuses are possible.
government	Inland Revenue will use accounts to calculate taxes to be paid.
citizens	local residents will want to know if the organisation will provide new jobs or – if the firm is unsuccessful – if this might lead to a loss of jobs. local council might use financial information (e.g. on profits) to estimate the effect on the local economy e.g. more housing or schools may be needed if the company is profitable and is likely to expand.

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Glossary of terms

Term	Meaning
assets	items owned by a company – for example, equipment, cash, etc.
creditors	people from whom we buy goods on credit and whom we have not yet paid, or others owed money e.g. bank. Creditors are shown in the Balance Sheet as a current liability.
current assets	current assets are more liquid – more easily converted into cash – than fixed assets. Current assets consist of stock, debtors and money (in bank or cash).
current liabilities	anyone to whom the firm owes money in the short term – e.g. bank overdraft, bills due, other creditors.
debtors	customers to whom we have sold goods on credit and who have not yet paid. Shown in the Balance Sheet as a current asset.
equity	the monetary value of the business which belongs to the owner.
expenses	these have to be paid in the running of the business – e.g. rent, wages, and electricity bills.
fixed assets	fixed assets are items owned by the firm, which will last a long period of time – e.g. premises, furniture.
gross profit (loss)	difference between cost of goods sold and sales revenue.
hire purchase	spreading the payments of a purchase over a period of time.
income	money the business receives in the form of sales revenue.
liquidity	the ability of a business to pay it debts in the short term.
mark-up	the difference between the buying and selling price of a firms product.

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net profit (loss)	if expenses are less than gross profit a net profit will occur. If expenses are greater than the gross profit, then a net loss will occur.
overheads	expenses of a business other than materials or labour.
trading account	this statement is prepared to calculate the cost of goods sold and the gross profit. If the sales figure is greater than the cost of goods sold then the firm has made a gross profit. If sales figure is less than the cost of goods sold then the firm has made a gross loss.
profit and loss account	after gross profit has been calculated any additional gains are added to gross profit and then expenses are deducted to find a net profit or net loss.
working capital	difference between current assets and current liabilities – i.e. cash/near cash (stock and debtors) owned by the business and money owing. It shows the ability of an organisation to pay its debts quickly.

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Section 2: Human Resource Management

Role of human resource management in organisations

Human Resource Management (HRM) describes the way in which people are looked after at work. It covers activities such as attracting people to fill job vacancies, training workers, agreeing terms and conditions of employment and so on. Human Resource Management is a new term and has replaced Personnel Management. Many organisations, however, have not changed the terms they use. They still have a Personnel Department and have not changed its name to the Human Resource Department.

One of the reasons for the change in description is that Human Resource Management moves on from the old idea of treating employees as a resource, like a machine, where hard work is rewarded only by better pay. HRM involves finding out how to encourage people to work hard, by treating them as human beings with their own goals. This often means that people will work in teams to solve problems, make decisions and sett their own targets.

HRM requires organisations to communicate their objectives to people at work. In return employees are encouraged to communicate their hopes and aspirations to managers in personal interviews reviewing the employees' working year. This is called an appraisal.

Why do people work? Different people work for different reasons but some of the most common ones are to:

- earn money for now and for the future
- become part of a team
- enjoy the work
- achieve success
- improve themselves.

Each worker has his or her own targets to achieve. Some want to earn money, others also want satisfaction and pleasure from working. Each business must help create an environment which lets its workers achieve their particular goals.

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Types of employment

- **Full time** – working a full week, for example from Monday to Friday from 9 am to 5 pm, although this set time is now changing with varying hours and more flexibility for employees
- **Part-time** – working fewer hours than those with full time contracts – for example, 16 hours per week.

Both full time and part-time jobs can last many years, or only two to three weeks as some are permanent and some are temporary.

- **Permanent** – this means that the job will last as long as the organisation requires.
- **Temporary** – this means that the job lasts for a short, often fixed, time. This is often called contract work and is generally used by businesses when they have a particular project underway eg building a city bypass. Some temporary jobs can last for a year or more. They are often called fixed term contracts.

Most jobs require employees to be working during agreed times each day, although some can be more flexible than others.

Flexible working or flexi-time requires workers to work:

- **core time –** a set time in the day when all workers attend, for example, from 10 am–12 noon **and** 2 pm–4 pm

  and

- **flexi-time** – outwith the core time employees can choose to start work or finish work early or later – whichever suits the particular individual and their circumstances. However, workers may be required to make up the standard hours required for the week/month.

Some organisations require to have people working round the clock either for necessity or for maximum efficiency and the most profitable use of resources. To achieve this staff work in **shifts**, ensuring that the organisation is running day and night. Employees will be paid higher rewards to make up for having to work unsociable hours.

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Main types of employee

Businesses employ two main types of employee. These are people who are:

- unskilled
- skilled.

Unskilled workers (also known as manual or blue collar workers or operatives)

Unskilled workers work in a variety of businesses where they perform manual or repetitive tasks.

Characteristics of unskilled workers include:

- no formal qualifications
- few work related skills
- limited work experience.

Unskilled workers are often called operatives. While the tasks carried out by operatives may be routine, they must be carried out with care and precision. Operatives need to feel valued and that they have the opportunity for training and promotion should they want this. Examples of types of operatives are:

- shelf-fillers
- checkout operators
- packers
- cutters.

Increasingly, operatives have to learn work-related skills (e.g. learning how to use information technology). The training that they receive and the experience that they gain at work often means that they cannot be described as unskilled. Sometimes they are referred to as semi-skilled. In other cases they are given job titles which show that their jobs require work-related skills.

Skilled workers (also known as professional or white collar workers)

Skilled workers tend to be multi-skilled and can perform a variety of different tasks. They are expected to be responsible for the quality of their output and to be motivated. Businesses employ large numbers of skilled workers.

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Characteristics of skilled workers include:

- they have formal qualifications
- they have skills, training or work experience related to the job
- they have responsibility within the organisation

Skilled workers also have to develop work-related skills relevant to the organisation within which they work.

Types Of Management

Managers organise the resources – including the employees – to gain the most benefit for the organisation.

Senior Managers

Top-level strategic decisions concerning the whole organisation are made by senior managers. These might include the market to sell in, the type of product to make, whether to expand or where to make economies.

Middle Managers

Middle managers organise resources within the guidelines set out by senior managers. They are often in sole charge of a department reporting to senior management at specified intervals. New ideas must be discussed with senior management before they are brought into being. The types of tasks organised by a middle manager might include:

- setting and controlling a department budget
- organising a sales force
- changing the price of some products.

Junior Management

Junior management are usually concerned with short-term, straightforward and routine operational decisions. The types of tasks a junior manager would perform might include:

- managing stock
- arranging the delivery of goods
- organising hours worked by staff.

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Supervisors

Supervisors know how things should be done at ground level. They work with middle and junior managers to put plans into action. The types of tasks a supervisor might perform include:

- set daily schedules
- identify and sort out operational problems
- give advice and guidance
- apply expert knowledge of production
- oversee work being carried out
- introduce new staff to work tasks
- keep check on levels of stock
- liaise with management.

Supervisors know the capabilities of all the resources, as they work with them daily. Supervisors issue daily commands and deal with day-to-day problems. They should have good mathematical and communication skills as well as a good knowledge of the technology of their industry.

Job Satisfaction

As people spend a great deal of their lives at work they expect to be rewarded and satisfied with their job.

What gives people job satisfaction?

- good pay
- feeling of worth/recognition of job well done
- possibility of increase in pay
- colleagues you get on with
- training opportunities
- good working hours
- job security
- fringe benefits
- employer/manager you can get on with
- possibility of promotion
- pleasant working environment
- variety of tasks to do
- possibility of differing tasks on same level, perhaps in another department
- challenging and interesting work
- good holidays.

The Human Resource Department in an organisation is responsible for ensuring that the terms and conditions of work enable employees to gain as much job satisfaction as possible.

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The Elements of Human Resource Management

Human Resource Management covers a range of functions within the organisation. It consists of the following elements:

- recruitment
- selection
- training and development.

All these elements are linked together. They cover all the stages which an employee passes through from joining an organisation to leaving it. The Human Resource Department is responsible for managing all these elements.

Recruitment

Recruitment means attracting a suitable number of people to apply for jobs within an organisation. Selection means choosing a suitable person to fill a job vacancy. In this case, recruitment and selection will be looked at separately.

Recruitment of employees at all levels below that of senior executive is normally done through the Human Resource or Personnel Department. The Human Resource Department will have considerable experience of what type of labour is available and whether it is available locally. The department will know of the rates of pay and conditions of employment offered by competitors, and of the organisation's personnel policy.

In almost all cases all the procedures up to preparing a list of possible employees will be carried out in the Human Resources Department, but the final list of interviewees and the ultimate selection of the final candidate will be a joint decision between the Human Resources Department and the department requiring the employee.

To get the right people to apply for a job, businesses must:

- identify the job that has to be done (**job analysis**);
- describe the job in detail (**job description**);
- describe the qualities of the person needed to do the job (**person specification or job specification**).

After a **job description** and a **person specification** have been prepared, the organisation should **advertise the job vacancy** (or vacancies). In many large organisations, the Personnel Department or Human Resource Department arranges the advertising and **deals with applications** e.g. by writing to

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applicants to let them know their application has been received. The Human Resource Department also does the administration once the selection process starts, e.g. it **arranges interviews** with applicants who have been chosen for interview.

Job Analysis
Each time a job needs to be filled the business has an opportunity to carefully analyse what the job actually involves.

This involves identifying the:

- tasks to be completed
- knowledge and skills needed
- level of initiative needed
- technology required
- inter-personal skills required
- the responsibility level of the job.

From the information gathered a **job description** and **person (or job) specification** can be prepared.

Job Description
Once the job has been analysed, a job description can be prepared. This is a description of what the job is and what it involves. The job description will include the tasks to be carried out and the behaviour needed to do the tasks successfully. A job description should contain all of the main details which relate to a job, for example:

- job title
- position in business
- job responsibilities
- purpose and objective of the job
- job standards.
- department
- job outline
- working conditions
- main duties.

A job description performs two important tasks:

- it allows possible applicants to see what the job will involve
- it helps the business to identify the type of workers they are looking for.

Person Specification (or Job Specification)
Once a job description has been prepared, the business will normally identify the personal qualities (known as attributes) of the person needed to do the job to the correct standard. The document detailing these qualities is called a person specification. The person specification describes the kind of person suitable for the job.

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Every position within a business requires particular skills, talents and aptitudes. A person specification identifies the main characteristics which the successful applicant will need in order to be able to do the job.

These include the following:

- the physical characteristics of the individual
- the achievements of the individual
- the intelligence of the individual
- the skills of the individual
- the interests/hobbies of the individual
- the personality of the individual.

The employer must be able to identify the person who has the best **potential** to effectively fill a particular position

Methods of Recruitment

The job analysis, job description and person specification mean that the Human Resource Department now knows what the job involves and the kind of person needed to fill it. The next step is for them to get applicants for the job.

There are two main methods of doing this:

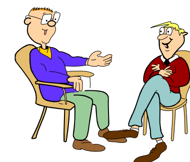
- Internal recruitment
- External recruitment

Internal Recruitment

This means that the job vacancy will be filled by someone who is already working for the company. The business may advertise the vacancy on notice boards, in internal newsletters or on an intranet webpage.

The advantages of internal recruitment are that:

- it gives existing employees the opportunity to develop their career
- employees are already familiar with the business, therefore little induction is necessary
- employees' strengths and weaknesses are known by the employer
- it is an inexpensive form of recruitment
- it can improve staff morale.



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The disadvantages of internal recruitment are that:

- quality applicants from outwith the organisation are excluded from applying for the job
- another job vacancy will arise from an internal appointment, which must then be filled
- no new ideas are brought to the company
- may cause jealousy/resentment in the organisation.

External Recruitment
The job will be advertised and filled from outside the company. The business may advertise the vacancy in local or national newspapers or in specialist publications. Such advertising allows the Human Resources Department to target specific sections of the population.

It must be remembered that not all the workers that an organisation needs will be permanent staff. Where temporary staff are required, the organisation may use recruitment agencies. Increasingly, businesses are using such agencies when recruiting staff. This saves the business money since they do not need to advertise or interview the staff.

The advantages of external recruitment are:

- a larger range of people can apply for the job
- new employees may bring fresh ideas to the business.

The disadvantages of external recruitment are that:

- it is a more expensive form of recruitment than internal recruitment
- it can lower staff morale as there may be less chance of internal promotion.

Advertising Jobs
Job advertisements should be short and accurate. They should describe the job and indicate the type of the person required, e.g. experience, qualifications, personal qualities etc.

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The common places or media for advertising jobs are:

- government job centres
- recruitment agencies
- national newspapers
- radio
- television
- internet
- notice boards in the business
- in-house magazines
- professional newspapers/magazines
- local newspapers
- schools/university careers officers
- careers/job fairs
- word of mouth
- public notice boards e.g. libraries, community centres.

NOTICE BOARD

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The choice of how to advertise will depend on the:

- frequency with which the organisation wants to advertise to job vacancy

- advertising budget

Relatively cheap forms of advertising:

- notice boards/in-house magazines
- local newspapers/local radio
- schools

More expensive forms of advertising:

- television
- recruitment agencies

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The wording of the job advertisement is very important. Many job adverts now include details of the 'perks' that come with the job and these might include:

- short working hours
- good or flexible holiday entitlement
- private health care
- flexible working hours/job sharing opportunities
- pension scheme
- company car or travelling expenses.

Application forms

These should collect **relevant** information from the candidate. Most businesses use Application Forms and design them to meet their own requirements. All Application Forms will contain sections for basic information such as:

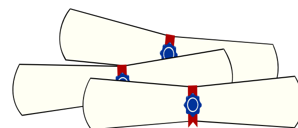
- name
- address
- telephone number
- date of birth
- education
- qualifications
- work experience
- interests
- hobbies
- referees.

Increasingly however, application forms ask applicants for more information such as:

- Why have you applied for this position?
- What makes you suitable for this position?

CVs (Curriculum Vitae)

CVs are prepared by most job applicants and provide a short summary of the applicant i.e. address, age, employment experiences, education and qualifications, interests/hobbies.



Some businesses ask for hand-written CVs so that clear writing and a good standard of English can be assessed.

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References
Applicants for jobs are often asked to provide references in addition to a completed application form or CV. References are comments on the applicant by someone who knows what the applicant can do. A previous employer, for example, could comment on an applicant's attendance and time-keeping at work.

The accuracy of information written in Application Forms should be checked by getting references from people known to the applicant.

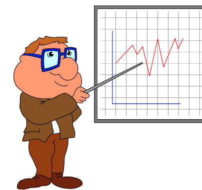
Selection

Choosing suitable candidates from those who apply is known as selection. A good selection process will make sure that those responsible for the selection decisions have as much information available as possible. The selection process will include:

- asking for and reading references
- looking at Application Forms and CVs
- using suitable methods of selection to decide which applicant to appoint.

Methods of selection
There are a number of methods that can be used to ensure that the correct candidate is selected. They include:

- application form and CV – provide background information on potential candidates
- interviews – allows for a face to face discussion, carried out either by one person or by a panel of people
- aptitude tests – for example, an applicant may be given a test to see if they have the skills needed for the job, e.g. a word processing test for an office junior post
- giving presentations on a relevant topic, for example, a sales manager may be asked to give a presentation on how to increase sales within the company.



Some organisations use a combination of methods – for example, applicants have an interview, give a presentation and are given aptitude tests. Applicants may also have to take part in group exercises.

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The most common method of selection is an interview. The purpose of an interview for the organisation is to find out as much information as possible about the applicant. However, it is also an opportunity for the applicant to find out about the organisation. The interview means that the organisation can find out how well the applicant meets the requirements of the person specification for the job.

A successful interview should involve the following:

- telling candidates how the interview will be conducted
- putting the candidates at their ease and telling them about the job
- asking questions so that the candidates have the opportunity to give full answers
- listening to the candidates' answers and asking follow-up questions.
- giving the candidates an opportunity to ask questions
- keeping the interview pace brisk
- indicating when the interview is over.

Impressions are important at interviews and dress and body language can affect the interview.

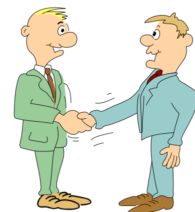
- Badly dressed candidates can present a poor image to the interviewers.
- Hostile questions from the interviewers can create self-doubt in the candidates.
- Fidgeting and looking uninterested (by either the candidate or the interviewers) leads to interviews being cut short.

To be equally fair to all applicants, they should all be asked the same questions.

After all applicants have been interviewed, the information obtained from each one can be compared to the person specification. Ideally, the organisation should choose the applicant who matches the person specification most closely.

Appointment

The successful candidate can then be offered the job. The Human Resource Department will be responsible for informing the successful applicant and for letting the unsuccessful candidates know what has happened.



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Contract Of Employment
Every employee receives a Contract of Employment when starting a new job. Under the Employment Act this must be given to employees within 13 weeks of starting work. A Contract of Employment contains the following details:

- title of the job
- holiday entitlement
- sickness pay and allowances
- discipline/grievance procedures
- date employment began.
- hours of work
- the rate and payment timing of wage/salary
- pension scheme
- notice required if employee intends to give up the job.

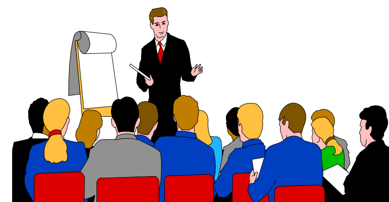
These details are the terms and conditions of employment for the person concerned. The Human Resource Department is responsible for issuing contracts of employment and for making sure that terms and conditions of employment are properly applied to all employees – for example, that employees are paid on time and that hours of work, etc., are agreed with employees.

Training and development

Staff training and development involves providing employees with new skills, knowledge and experiences so that they can carry out their jobs efficiently.

Induction
On the first day, or shortly after starting work, staff will be invited to an induction course. The purpose of an induction course is to introduce new employees to the firm, its organisation and its procedures, including those of the department he/she will work in.

Possible activities for an induction course:



- welcome and introduction by the Human Resource Manager
- watching a video about the organisation
- receiving and discussing the staff handbook
- completing a staff record card
- giving tour of the firm
- giving details of employment (contract of employment)
- showing social facilities available and/or benefits e.g. staff canteen
- introducing colleagues in the department the employee will work in
- being shown what types of jobs the employee will be doing.

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Job Training

Selecting and recruiting the best people for your business is not enough. It is also important to make sure that they work well after they have joined the business. This can be done by giving employees opportunities for training and development.

Training is the key to ensuring that a business can remain successful in an increasingly competitive environment. It makes sure businesses have a skilled, motivated and effective workforce.

Training methods will vary to suit the individual needs of each business. Whatever method is selected, training must:

- improve the skills of its workers so they can cope with changes in the business world e.g. due to improvements in technology, increased competition, health and safety regulations
- make sure that workers can achieve the quality of working standards needed to keep the business competitive
- benefit the employee by developing skills and confidence
- be available throughout an employee's working life, i.e. life long learning
- help ensure safety in the workplace
- prepare employees for future promotion.

Training can be:

- **on the job** – training arranged within the firm either by the department manager or the Human Resources Department. It is usually done by an experienced worker who is an expert in the field.

- **off the job** – the employee will go outside the business to do their training e.g. college, training centre, day release.

Costs and Benefits of training

Costs	Benefits
• The financial costs of training can be high eg cost of specialist training staff	• Staff become more efficient at carrying out their work – therefore productivity will increase
• Working time and output are lost when staff are taking part in training	• Staff become more flexible and can carry out a range of tasks
	• Staff motivation and morale increases
	• The image of the organisation will improve

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Staff Appraisal
This is a report on how well an employee is progressing. It is usually carried out at regular intervals (normally once a year) by the employee's line manager. The process may require the completion of an appraisal form by both parties. This is then followed up with a formal interview. Appraisals are used to:

- evaluate performance
- identify employees suitable for promotion
- increase motivation
- identify training needs
- set future performance targets
- identify the strengths and weaknesses of staff
- assess the success recruitment and selection process
- improve communications
- award salary increases
- plan future staffing.

Appraisal, however, can only be successful if targets are set for performance. Target setting can be used for issues such as:

- attendance at work
- quality of work
- communication abilities
- level of output achieved
- training to be undertaken
- relationships with other staff.

Employee relations

'Employee relations' is a term that refers to the way that employers deal with their employees. They cover the normal relations between management and employees. The Human Resource Department is responsible for ensuring that a suitable framework is set up to enable employers and employees to discuss matters which affect them. Employee relations is a relatively new term and it has replaced the old term 'industrial relations'. Traditionally most discussions take place between employers (represented by managers) and employees (represented by trade unions).

Employee relations cover many things such as disciplinary and grievance procedures, staff welfare and terms and conditions of employment.

The role of management

The role of management in employee relations is to inform, consult and negotiate with employees and their representatives. This may mean:

- meeting with trade union representatives
- having an employee representative on the Board of Directors

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- having regular meetings to inform employees of decisions made by management
- forming a works council.

The Human Resources Department sets up these channels of communication. It also checks to make sure that they are working properly.

The role of the employee

Employees should comply with relevant legal requirements and use the correct channels of communication within the organisation.

The role of trade unions

Trade unions represent employees when dealing with employers in national and local discussions. This could involve bargaining for higher wages, better working conditions or better terms and conditions of service within an organisation. The union can also assist with grievance procedures by providing legal advice to members. They also give members financial advice. Members pay a subscription to become a member of the union.

The role of works councils

Works councils are made up of an equal number of representatives from employees and management. At meetings of the works council, people can discuss matters affecting the business, especially the impact they have on the workers.

The things that works councils do vary a lot between different organisations. In some cases, they are simply of way of getting employers and employees together to discuss things. In other cases, works councils may agree terms and conditions of employment e.g. where there is no trade union in the organisation.

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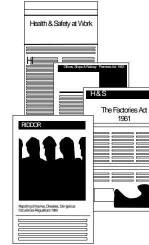
Legislative requirements

Employment legislation falls into two categories:



- health and safety legislation which covers physical working conditions
- employment legislation which covers the terms and conditions under which employees work.

Health and Safety

The Health and Safety at Work Act 1974
This Act places a responsibility on employers and employees to maintain safe working conditions. Employers must take reasonable care to ensure the health, safety and welfare of all employees. Employees must take reasonable care to ensure both their own safety and the safety of other employees who may be affected by what they do.

The Health and Safety at Work Act brought together a lot of earlier legislation on health and safety. Some of this still applies – for example, the Factories Act 1961 and the Offices, Shops and Railway Premises Act 1963.

The Factories Act applies to a wide range of factory premises including garages while the Offices, Shops and Railway Premises Act covers non-manufacturing premises. Both deal with aspects of health and safety such as lighting, temperature, ventilation, overcrowding, washing facilities, first aid and fire precautions.

The government appoints Health and Safety Inspectors who check premises to make sure that the legislation is not being broken.

Reporting of Injuries, Diseases and Dangerous Occurrences Regulations, 1985 (RIDDOR)
These regulations require any injuries resulting from accidents at work to be reported to the authorities within seven days.

Control of Substances Hazardous to Health Regulations, 1988 (COSHH)
This Act requires that workers dealing with hazardous substances must be given detailed information and training.

Noise at Work Regulations 1989
Employers must reduce the risk of hearing damage to employees to the lowest practical level – for example, by providing ear protectors when noise reaches a certain level.

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Employment legislation

Discrimination

There are major laws governing discrimination which any business must consider when making decisions regarding employment. Equal pay, sex, race, health and safety, unfair dismissal – these are all areas where employees have protection. There is also legislation on a minimum wage.

The following Acts protect employees:

The Equal Pay Act 1970

The Act states that if a woman is doing the same or broadly similar work to a man, then she is entitled to the same rate of pay, and that women doing the same work as men should also receive the same terms of employment – i.e. the same holiday entitlement, sick leave, working hours, bonuses etc.

The Sex Discrimination Act 1975

This Act states that it is unlawful to treat a woman, or a man, less favourably on the grounds of sex. Both sexes should be treated equally in employment, training, education, public facilities and public services. It is unlawful to discriminate against someone because they are married.

The Race Relations Act 1976

The Act states that it is against the law to treat a person less favourably than others on grounds of colour, race, nationality or ethnic or national origins.

If an employee feels they have been unfairly treated because of their race with regards to redundancy, dismissal, discrimination or sexual harassment the employee can bring these issues to an Industrial Tribunal, which does not require lawyers.

Disability Discrimination Act 1995

This covers discrimination against disabled persons. Employers may not discriminate against a disabled person for a reason related to his or her disability.

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Glossary

Some of the terms which are in the notes are explained a little more fully below. There are also some terms which have appeared in other units but which are also relevant to human resources included in the glossary.

Term	Meaning
appraisal	the system of monitoring an employee's performance in order to identify strengths and weaknesses.
collective bargaining	when one or more unions negotiate with employers on behalf of employees to determine conditions of work and terms of employment.
delegation	when a superior gives tasks to a subordinate, this will give him or her more experience and free up the leader to complete other tasks.
dispute	a breakdown in the relationship between employers and employees.
flexible workforce	a workforce which can respond quickly to changes in the requirements of the organisation.
go-slow	a reduction of output by workers whilst still carrying on their tasks.
lock-out	a situation where employees are physically kept out of their place of employment.
multi-skilled	the ability of employees to switch easily from one operation to another.
non-financial rewards	sometimes called fringe benefits (or perks) which are used to motivate employees, e.g. low cost loans, free canteen, company car.
picketing	an attempt by trade union members to dissuade others from working during industrial action.
piece rate	rewarding employees for the number of items they produce.
quality circle	a discussion group that meets regularly to identify problems.
redundant	the situation where a job no longer exists.
single union agreement	an agreement by an employer to recognise and negotiate with one union only.

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unofficial action/strike	union activity/strike which is spontaneous and does not have the backing of the union head office.
verbal warning	first stage of a fair dismissal.
written warning	final stage prior to being fairly dismissed.

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