Case study

Norford's is a small business that manufactures testing equipment. Its customers are other businesses that need to test the quality of their own products. For example, a crane manufacturing company might want to test the strength of a piece of steel when put under pressure. At what stress level will it snap? An aircraft manufacturer might want to test at what temperature – both high and low – a component might explode due to extreme heat or cold.

Norford's operates in a market with only a small number of competitors. Like many businesses, it can set its own prices. However, this is very different from some of the firms from which it buys. Some of these suppliers have to accept the price that the market dictates. One example is suppliers who manufacture steel. Steel firms produce a commodity product. The price of steel is determined on international markets like the London Metal Exchange. Here buyers and sellers of steel from all over the world meet to agree trades, which set the price for steel. When demand for steel falls, even by a few per cent, there can be a large fall in the price of steel. Norford's uses a lot of steel in its products. Changes in steel prices can have a major effect on Norford's costs – either increasing them or cutting them.

Interest rates are another major cost that Norford's has to face. It has loans and an overdraft of £50,000. If interest rates fall, this can help cut the interest payments that the business has to make. If interest rates rise, the increase in costs can be damaging to the cash flow of the business.

Interest rates are likely to fall if the economy suffers a downturn. When this happens orders for equipment from Norford's can fall dramatically, as the customers it supplies cut back on their spending. The situation only gets better when consumer spending picks up again. Until that time firms will not feel confident about ordering new equipment; why should they if they do not think they will sell what they are producing?

One positive aspect of a downturn in the economy for Norford's is that the value of the pound is likely to fall. This makes its exports more price competitive. Without a fall in the exchange rate, the drop in orders could be even greater.

In a time of economic downturn, Norford's has some difficult decisions to make. It employs 11 workers. Should it make some workers redundant? If the firm is making a loss, the two owners of the business will not be able to take any profit out of the business. If this happens then Norford's has to investigate other ways in which it could cut costs. Could it squeeze its suppliers more by negotiating lower prices? Could it use the fall in the exchange rate to put up its prices to foreign customers?

Suggested discussion points/answers

1. How might Norford's be affected by each of the following?

(a) There is a sharp cut in worldwide demand for oil.
(b) The Bank of England decides to raise interest rates.
(c) The value of the pound rises against the euro.
(d) The economy goes into recession.

(a)
- depends on how much oil it uses in production
- If it is a major factor used in production then costs could rise significantly

(b)
- Costs increase – the interest it pays on loans will rise
- Demand falls as consumers' disposable income falls
- Will have an adverse effect on cash flow
- Interest on any savings increases

(c)
- exports become less competitive
- Possible fall in demand from overseas
- More competitive in the UK against foreign imports
- The price it pays for any imported materials will fall – they have to give up fewer pounds to get the same amount of foreign currency.

(d)
- Demand falls
- Lay off staff
- May have to close
- Norford's owners could lose their investment if the business does have to close

2. Who are the stakeholders in Norford's highlighted in the passage?

- Suppliers
- Customers
- Workers
- Owners

3. How might an increase in demand for testing equipment affect Norford's stakeholders?

- Suppliers = positive, more supplies needed
- Customers = positive, able/willing to buy more, more confident
  = negative, may have to wait longer for goods
- Workers = positive, more jobs, wage increases, greater job security
- Owners = positive, profit, expanding business