Business and its environment

A-Level Business

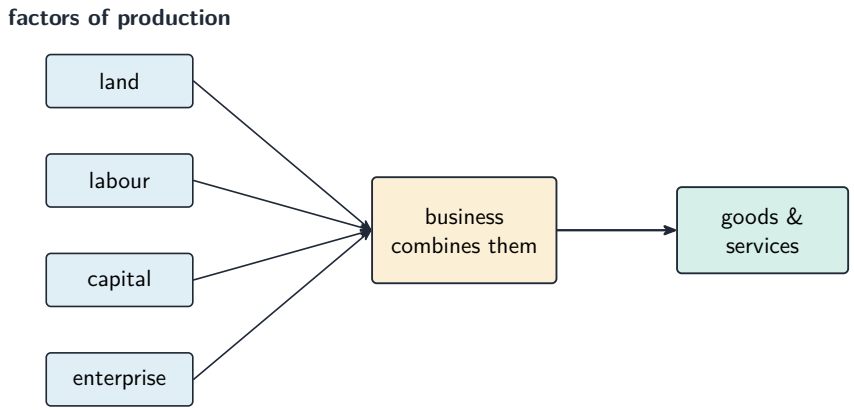
Why businesses exist

People have **needs** (things you must have, like food and shelter) and **wants** (things you would like, like a phone or a holiday). A business exists to meet these needs and wants by making **goods** and **services**.

Shops competing on a high street – the market a business operates in.

To do this, a business uses **resources**. We sort resources into four **factors of production**:

- **land** – natural things, such as soil, water and minerals.
- **labour** – the work done by people.
- **capital** – the machines, tools, buildings and money used to produce.
- **enterprise** – the skill of bringing the other three together and taking the **risk** to start a business.



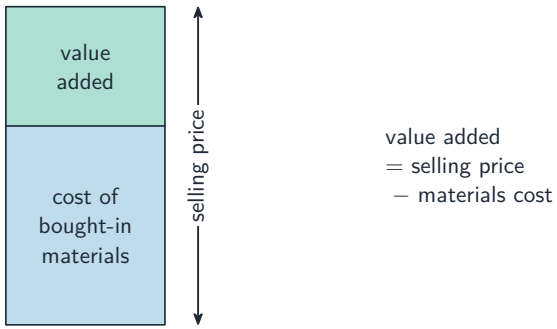
Land, labour, capital and enterprise are the four factors a business combines to make goods and services

Resources are **scarce** – there are not enough to meet everyone's wants. So every business must choose how to use them well.

Adding value

Adding value means the selling price of a product is higher than the cost of the **inputs** (the bought-in materials) used to make it.

$$\text{value added} = \text{selling price} - \text{cost of bought-in materials}$$



Value added is the selling price minus the cost of bought-in materials

A business can add value by **branding**, better quality, good design, fast service, or convenience. More value added can mean more **profit**, but only if costs stay under control.

Entrepreneurs and intrapreneurs

An **entrepreneur** is a person who takes the risk to set up and run a business. They have the idea, organise the factors of production, and make the decisions. If the business fails, they can lose their money.

An **intrapreneur** is an employee inside a larger business who acts like an entrepreneur. They build new ideas, products or ways of working, using the company's resources.

A food truck is enterprise you can see. The owner spotted a gap, spent their own savings on the van and stock, and now takes the daily risk of running it – the essence of being an entrepreneur

Characteristics of successful entrepreneurs

Successful entrepreneurs are usually:

- **innovative** – full of new ideas.
- willing to take risks, but in a careful way.
- hard-working and **determined** – they do not give up easily.
- **self-confident** and good at making decisions.
- good leaders who can plan ahead and manage money.

Why enterprise matters to a country

When people start new businesses (**business start-ups**), the whole country can gain:

- new jobs are created, which lowers **unemployment**.
- more goods and services are made, which raises **output** (and the country's **GDP**).
- more **competition**, giving customers lower prices and more choice.
- some firms grow and **export**, bringing money into the country.
- **economic growth** and a higher standard of living.

The business plan

A **business plan** is a written document that describes the business idea and how it will work. It usually contains:

Part of the plan	What it covers
The idea	the product, and what makes it different
The market	target customers, market size, competitors
Marketing	price, promotion and place
Operations	how the product is made or delivered
Finance	start-up costs, a **cash-flow forecast**, expected profit
People	the owners and key staff

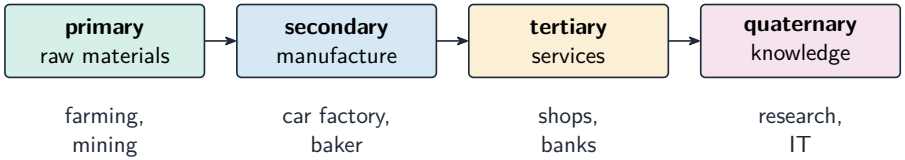
A business plan is useful because it helps the owner:

- get **finance** from a bank or an **investor**.
- set clear goals and lower the risk of failure.
- guide decisions as the business grows.

Sectors of business activity

Every business works in one of four sectors:

Sector	What it does	Example
primary sector	takes raw materials from nature	farming, mining, fishing
secondary sector	makes (manufactures) goods	car factory, baker
tertiary sector	provides services	shops, banks, transport
quaternary sector	knowledge and information services	research, IT, consulting



Business activity runs from the primary sector through to the quaternary sector

Here **raw materials** are the natural inputs a business starts with, and to **manufacture** means to make goods in large amounts. As a country develops, it usually moves from mostly primary work towards more tertiary and quaternary work.

Private and public sectors

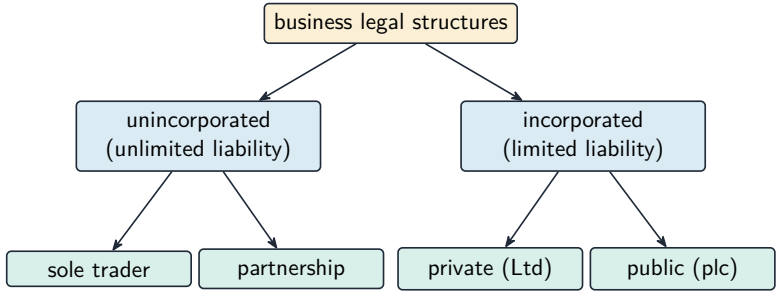
- The **private sector** is made up of businesses owned by private people. Their main aim is usually profit.
- The **public sector** is made up of organisations owned by the government, such as state schools and public hospitals. Their aim is usually to provide a service, not to make profit.

Legal structures of business

A company headquarters: businesses range from sole traders to giant public limited companies.

A business must choose a legal form. The main ones are below.

- A **sole trader** is owned by one person. It is easy to set up and the owner keeps all the profit, but raising money is hard.
- A **partnership** is owned by two or more partners who share the work and profit. They often sign a **deed of partnership** that sets out each partner's share.
- A **private limited company** (Ltd) sells **shares** to a small group, such as family and friends. Its owners are **shareholders**. Its shares are not sold to the public.
- A **public limited company** (plc) sells its shares to the public on the **stock exchange**. It can raise large amounts of money, but it must follow more rules and faces the risk of a **takeover**.
- A **franchise** lets one firm use another firm's brand and business model. The **franchisor** owns the brand; the **franchisee** pays a fee and a **royalty** to run a branch.
- A **joint venture** is when two businesses join to run one project and share the costs and risks.
- A **social enterprise** trades like a normal business but aims to do social or **environmental** good, and reinvests most of its profit.



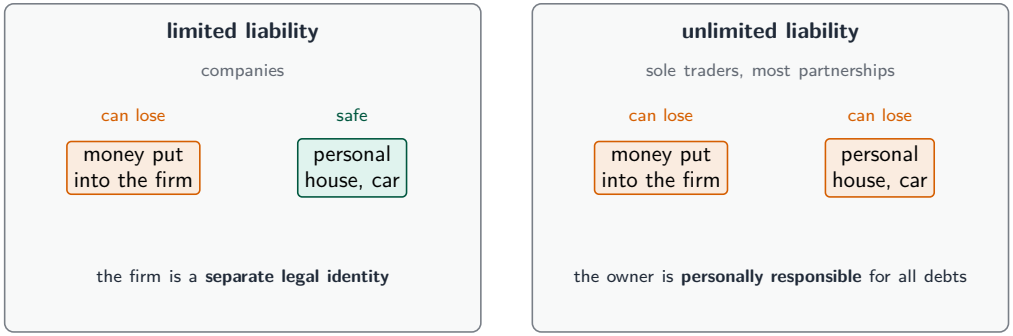
Legal forms split by liability: unincorporated (unlimited) and incorporated (limited)

Limited and unlimited liability

Liability means who must pay the business's **debts** if it cannot pay them itself.

- **limited liability** – the owners can only lose the money they put in. Their personal things, like a house or car, are safe. Companies have limited liability.
- **unlimited liability** – the owners are personally responsible for all the debts. They could lose personal things. Sole traders and most partnerships have unlimited liability.

A company is a **separate legal identity** – it can own things, owe money, and be taken to court in its own name, apart from its owners.



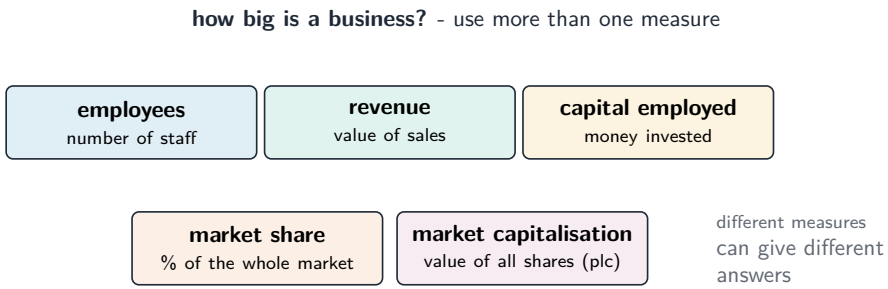
Limited liability risks only the money put in; unlimited liability risks the owner's personal things too

The size of a business

There is no single best way to measure how big a business is. Common measures are:

- the number of **employees** .
- **revenue** (also called sales turnover) – the value of what it sells.
- **capital employed** – the total money invested in the business.
- **market share** – the firm's sales as a percentage of the whole market.
- **market capitalisation** – the total value of a company's shares (for a plc).

Different measures can give different answers, so it is best to use more than one.



Five ways to measure how big a business is; use more than one

■ Why small businesses matter

Small businesses create jobs, serve local **communities** , give personal service, react quickly to change, bring new ideas, and supply parts and services to large firms.

Business growth

A business can grow in two ways.

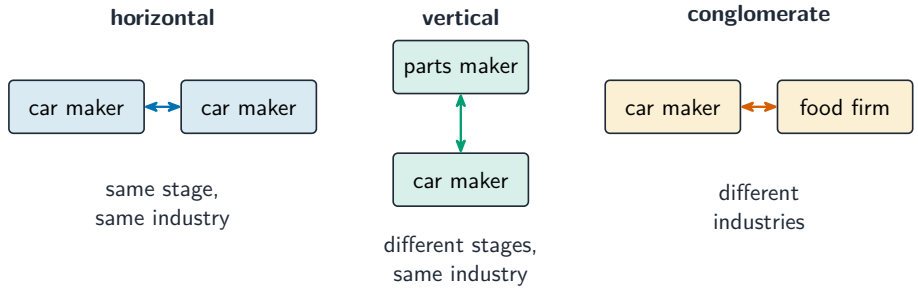
Internal growth (organic growth) – the business grows by itself: selling more, opening new branches, or adding new products. It is slower but lower risk.

External growth – the business joins with another firm. This is called **integration** , and it happens by:

- a **merger** – two firms agree to join together as one.
- a **takeover** – one firm buys control of another.

There are three types of integration:

- **horizontal integration** – joining a firm at the same stage in the same industry (e.g. two car makers).
- **vertical integration** – joining a firm at a different stage in the same industry. **Forward integration** is towards the customer (e.g. buying a shop); **backward integration** is towards the supplier (e.g. buying a parts maker).
- **conglomerate integration** – joining a firm in a completely different industry. This spreads risk, which is called **diversification** .



The three types of integration when one firm joins with another

Firms grow to lower their costs, win a bigger market share and more **market power** , raise profit, and spread risk. But growth also brings problems: higher average costs, harder management and communication, different company **cultures** that may clash, and a need for a lot of finance.

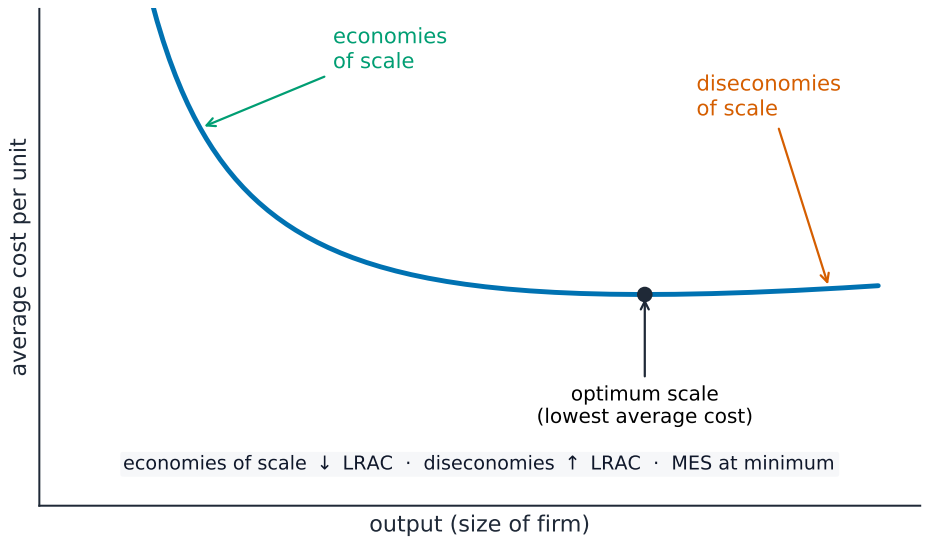
Economies and diseconomies of scale

Economies of scale are the cost savings a business gets as it grows larger. The **average cost** of each unit falls as output rises. The main types are:

Type	How it lowers cost
purchasing	buying in **bulk** earns discounts
technical	large machines are more efficient
financial	large firms borrow at lower **interest**
managerial	the firm can employ expert specialist managers
marketing	advertising cost is spread over more units

Diseconomies of scale happen when a firm grows too big and the average cost starts to rise again. The usual causes are:

- **communication** becomes slow and unclear.
- the **coordination** of many departments is hard.
- workers may feel unimportant and lose **motivation** .



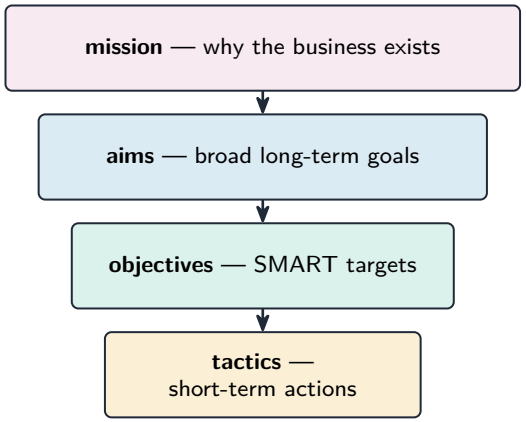
Average cost per unit falls (economies of scale) then rises (diseconomies of scale) as a firm grows

> **Worked example.** A factory making 10,000 units has fixed costs of £200,000 and variable costs of £6 per unit. It expands to 50,000 units, and bulk buying cuts the variable cost to £5. Find the unit cost at each output and explain the fall. Unit cost = total cost ÷ output. At 10,000: total = 200,000 + (10,000 × 6) = £260,000, so the unit cost is 260,000 ÷ 10,000 = **£26**. At 50,000: total = 200,000 + (50,000 × 5) = £450,000, so the unit cost is 450,000 ÷ 50,000 = **£9**. Two economies of scale are at work: the **fixed** costs are spread over far more units (£20 down to £4 each), and **purchasing** economies cut the variable cost. Note that the fixed cost **total does not change** - only the fixed cost **per unit** falls. Writing "fixed costs fall" is the error that loses the mark.

Aims, objectives and mission

A **mission statement** is a short sentence that says why the business exists and what it wants to be. It guides everyone in the firm.

From the mission come **aims** (broad, long-term goals), and then **objectives** (the specific targets that help reach the aims).



Goals get narrower and more specific down the chain: a broad mission becomes aims, then SMART objectives, then day-to-day tactics

Good objectives are **SMART** – the first letters of:

- **Specific** – clear and exact.
- **Measurable** – you can check it with numbers.
- **Achievable** – it is possible to reach.
- **Realistic** – sensible for the resources you have.
- **Time-bound** – it has a deadline.

A **strategy** is the long-term plan to meet objectives. **Tactics** are the short-term actions that carry out the strategy. Objectives are shaped by the size and age of the firm, who owns it, the company culture, and conditions in the market.

Types of business objective

Objective	What it means
profit maximisation	making the largest possible profit
growth	getting bigger – more sales, more branches
survival	staying in business, vital for new firms and in hard times
market share	winning a larger share of the market
social and **ethical** objectives	doing what is morally right, such as fair pay

SMART objective

S	Specific — clear and exact
M	Measurable — uses numbers
A	Achievable — possible
R	Realistic — sensible
T	Time-bound — has a deadline

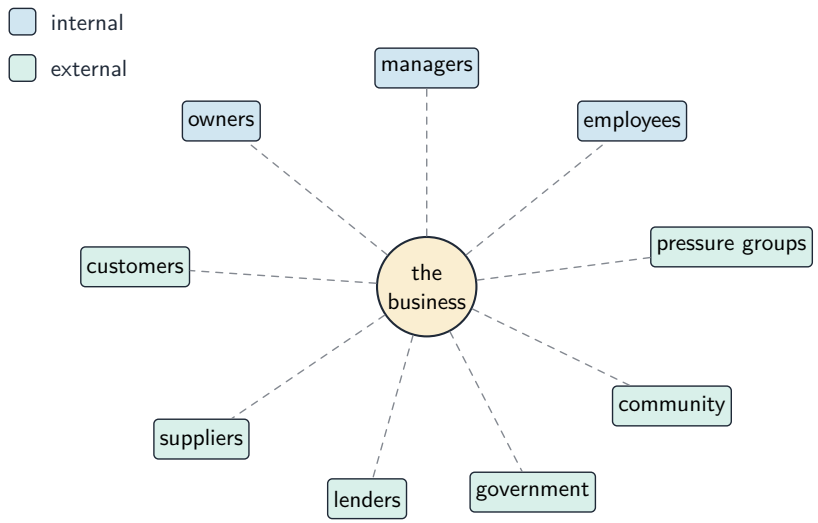
SMART objectives: Specific, Measurable, Achievable, Realistic, Time-bound

Corporate social responsibility (CSR) is the idea that a business should act in the best interests of society and the environment, not just make profit. Examples are treating workers fairly, cutting **pollution**, and helping the local community.

A firm's objectives can change over time. A new firm may aim to survive; later it may aim to grow; a large, safe firm may focus on profit or CSR.

Stakeholders

A **stakeholder** is any person or group with an interest in a business and how well it does.



Internal and external stakeholders all have an interest in the business

Internal stakeholders are inside the business:

- **owners** and shareholders – want profit and a good return.
- **managers** – want growth, job security and bonuses.
- employees – want fair pay, safe work and job security.

External stakeholders are outside the business:

Stakeholder	Main objective
customers	good quality at a fair price
suppliers	regular orders, paid on time
lenders (banks)	to be repaid with interest
the government	tax, jobs, and that the firm obeys the law
local community	jobs, but little pollution or noise
pressure groups	to protect a cause, such as the environment

■ Why stakeholder objectives conflict

Stakeholders often want different things, so their objectives can **conflict** (clash). For example:

- owners want higher profit, but employees want higher pay – and higher pay lowers profit.
- customers want low prices, but owners want a high profit margin.
- the local community wants less pollution, but cutting pollution can raise costs.

How conflict can be managed

- keep good communication with every group.
- **compromise** – give each group part of what it wants.
- **negotiation** – talk until the groups reach an agreement.
- decide which stakeholders matter most for each decision, and act on that.

Exam tips

- Define **added value** = selling price − cost of bought-in inputs, and give a way to raise it (branding, quality, design).
- Distinguish **unlimited vs limited liability** and link it to sole trader/partnership versus Ltd/plc.
- Measure business **size** in more than one way (employees, revenue, capital employed, market share) – note each has limits.
- Distinguish **objectives** (SMART, specific) from a **mission** (overall purpose).
- In evaluation, use **stakeholder conflicts** (owners vs employees vs community) to argue both sides.

Vocabulary card meanings

needs: Basic requirements a person must meet, such as food and shelter. determined: Unwilling to give up until a difficult aim is reached. self-confident: Sure of one's own ability to succeed. business start-ups: New firms in their first stage of trading. GDP: The money value of final goods and services produced inside a country in one year, so intermediate goods are not added a second time. quaternary sector: The part of the economy that sells knowledge and information services. manufacture: To make goods in quantity, usually in a factory. deed of partnership: The written agreement that sets out how partners share a firm. public limited company: A company allowed to offer shares to the public, which need not be listed on an exchange. The paired Chinese term names only a listed firm. franchise: A licence to operate an outlet using another firm's name and methods. franchisor: The owner of a brand who sells others the right to use it. franchisee: The independent owner who pays a parent firm for the right to run one outlet under that firm's brand. royalty: A fee paid for the right to use a brand or a business format. environmental: Concerned with the natural surroundings in which a firm operates. liability: What a person or a firm can be forced to pay if things go wrong. separate legal identity: The company counts as its own person in law, distinct from its owners. communities: The people who live or work around a firm and are affected by it. forward integration: A firm taking over a business closer to the final customer. backward integration: A firm taking over a supplier that sits earlier in its chain. company culture: The shared habits and values inside a firm. bulk: A large quantity bought or produced at one time. realistic: Able to be achieved with the resources the firm actually has. corporate social responsibility: A firm's duties to people and the environment beyond making profit. internal stakeholders: People inside the firm, such as owners and staff, who are affected by its decisions. external stakeholders: People outside the firm, such as customers and neighbours, who are affected by it. lenders: People or banks that provide borrowed money.