



Cambridge International AS and A Level

Business

Revision Guide

Second edition

Peter Stimpson and Peter Joyce

Completely **Cambridge**
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for
Cambridge qualifications



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Peter Stimpson and Peter Joyce

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How to use this book

Learning summary

After you have studied this chapter you should be able to:

- understand what business activity involves
- understand what 'added value' and 'creating value' mean
- recognise what makes a successful entrepreneur
- assess why enterprise is important to a country
- understand what a business needs to succeed and why some new enterprises fail
- recognise what social enterprises are and how they differ from other businesses.

Learning summary – a summary list of key topics and concepts that you will be looking at in this chapter, to help with navigation through the book and give a reminder of what's important about each topic for your revision.

TERMS

Added value: the difference between the cost of purchasing raw materials and the price of the finished good.

Creating value: increasing the difference between the cost of bought in materials and the price finished goods are sold for.

Terms – clear and straightforward explanations are provided for the most important words in each topic.

TIP

All measures of size have shortcomings. It is best to use a measure in the context of an industry/sector and over time.

The level of profit made by a business is *not* a good measure of size. It may be a useful indicator of performance/effectiveness but not size.

Tip – quick suggestions to remind you about key facts and highlight important points.

Progress check A

- 1 What capital equipment would a hairdressing business need?
- 2 Where is an entrepreneur likely to locate a new shop selling mobile (cell) phones?
- 3 What types of workers would an entrepreneur operating a road transport business most probably need to employ?
- 4 A business making clothes has managed to use ten per cent less material on each item of clothing by using a new cutting machine. Explain what will happen to the 'value created' by this business.
- 5 Explain how a computer could either be sold as a 'consumer good' or a 'capital good'.

Progress check – check your own knowledge and see how well you are getting on by answering regular questions.

Exam-style question

Paper 1 (short answer question)

- 1 Explain briefly the rights of two of a supermarket's stakeholders. [3]

Student's answer

A supermarket will have many stakeholders, e.g. workers and local communities in which the shops operate. These are just two of the groups interested in the decisions and activities of a supermarket.

Workers have legal rights and these would include a contract of employment and working conditions that meet health and safety standards.

Local communities have the right to be asked if the supermarket is planning a large expansion of its shop. Members of the community might be worried about the extra traffic and deliveries by large truck. The community, e.g. local government, might have some control over planning rules.

Authors' comments

This answer is just the right length. It is important not to write too much for the short answer questions as a detailed essay question also needs to be answered on Paper 1.

The answer is clear, concise and accurate – an excellent answer.

Additional exam-style questions

Paper 1 Section A

- 1 a Explain the term 'sole-trader business'. [3]
b Explain why a sole-trader might take on a partner. [3]

Section B

- 2 a Explain why the concept of limited liability is important to both shareholders and limited companies. [8]
b Discuss whether a retailing business that plans to set up operations for the first time in a foreign country should establish a joint venture with a retailing company in that country. [12]

Paper 2

Spanish Minerals Ltd. (SML)

'I do not see how we are going to compete with ROC Incorporated', said Joe Sainz, the managing director and main shareholder of SML. This is a private limited company that extracts minerals from three quarries in Spain. 'As one of the largest public limited mining companies in the world, ROC Inc's decision to start up operations in Spain by opening a huge new quarry could force us out of business! We operate in the private sector and have no government support.'

'We have capital saved from retained profits and we could consider conversion to a public limited company', said the other main shareholder of SML Pablo Massa. 'With the capital raised we could aim to become a highly mechanised and efficient supplier of high grade minerals. If the sale of shares was successful, we could also become very rich!'

'Perhaps', Joe replied, 'we should focus on our cement factory which uses some of the minerals we extract. If we concentrated on processing minerals rather than mining them, we could use ROC as one of our suppliers or even form a joint venture with the company'.

- 3 a i Define the term 'private limited company'. [2]
ii Briefly explain the term 'private sector'. [3]
b Using examples from the text, explain the difference between primary sector activity and secondary sector activity. [6]
c Analyse the reasons why SML might gain from forming a joint venture with ROC. [8]
d Evaluate whether Joe and Pablo should convert SML into a public limited company. [11]

Exam-style questions/Additional exam-style questions – these questions enable you to test your knowledge and understanding at the end of each chapter. The answers are provided at the back of the book.

Chapter levels – chapters have been colour-coded as either AS or A Level in order to help guide you through the book's content, with **AS chapters coloured orange** and **A Level chapters coloured green**.

Introduction

Purpose of this revision guide

Cambridge International AS and A Level Business Revision Guide has been written to support students working towards these important qualification. The guide follows exactly the order of topics contained in the current Cambridge International AS and A Level Business syllabus produced by Cambridge International Examinations and the endorsed textbook *Cambridge International AS and A Level Business Coursebook* published by Cambridge University Press (Stimpson/Farquharson ISBN 9781107677364). The guide is so comprehensive that it will also prove to be invaluable to students following other similar courses such as AQA A Level and IB Business and Management.

The Revision Guide has four main objectives:

- 1 To explain important subject content, concepts and techniques using easily remembered approaches.
- 2 To give a clear understanding to students of the key skills that each type of examination question requires.
- 3 To allow for practice at planning and answering examination-style questions.
- 4 To encourage students to avoid the most common errors in their answers but include the most relevant points of analysis and evaluation.

What makes this book different?

- It is written by two experienced examiners with many years of teaching and examining experience in Business.
- It does not just focus on subject content – it is not designed to be a textbook – but also gives clear guidance on how students can improve skills so that they can do better and achieve high grades by preparing appropriate answers.
- It contains example student answers and answer plans to 40 exam-style questions – with invaluable comments and advice from the authors on these.
- It uses a variety of different presentational styles to make it easier to revise and learn important material and essential Business concepts.
- The student answers to the exam-style questions and the outline answers at the end of the book have been written by the authors.

Note

Cambridge International Examinations bears no responsibility for these answers or for the comments offered. Inevitably, discursive style questions can have a variety of possible answers – in Business there are often no ‘right’ or ‘wrong’ answers. The suggested answers provided should be seen as only one possibility, designed to illustrate the approach rather than the answer itself.

The style of each chapter follows the same format and the key features are:

Chapter section	Purpose of each section	How to use each section
Learning summary	Outline the key objectives to be reached as you work through the chapter.	These objectives serve as a checklist of your progress through each chapter.
Bullet points and diagrams of important subject content	Key subject knowledge that is presented in an easy to recall style.	Use these as summaries of the important subject knowledge covered by the main textbook.
Notes with key definitions, formulae and common errors to avoid	Summarise the main terms and formulae in AS and A Level Business and the common mistakes to avoid.	Test your knowledge against these definitions and formulae and make sure you avoid the common mistakes!
Progress check questions	Test your understanding of the subject content covered by each topic.	If in doubt about any of these go back and re-read the topic or the textbook.
Exam-style questions	Allow practice at answering typical examination questions.	Authors' comments allow you to see what is important and compare your own answers against sample answers.

Explanation of the features in each chapter

Each chapter title is drawn from the headings used in the specification.

TIP

Obtain a copy of the syllabus (you are studying), and example papers/mark schemes and keep them in your Business file.

Tips on how to revise

Different people revise in different ways and the aim of this section is not to make you change the way you revise – if it works well for you and you get the results you are capable of then stay with that!

However, there are some important steps that anyone can take to improve the effectiveness of the revision period.

Place

- Find a quiet place to study – but sometimes, testing yourself with friends can be a useful checking process and can lead to discussion of important ideas and common problems.
- Make sure you are sitting comfortably – perhaps, at a well-lit desk.
- Avoid studying in an area where there will be distractions – such as television!

Planning

- This is very important as it is so easy to waste valuable revision time.
- Allow plenty of time for revision – especially if you are taking more than one AS or A Level subject.
- List all of your exam subjects and the amount of time you think you will need for each one.
- Divide each subject into major topic areas (use your copy of the syllabus to help you) and allocate sufficient time to revise each one – allow more time for the topics you find most difficult.

- Vary your revision plan – do not revise one topic or even one subject for a whole day but include other subject areas to avoid becoming bored with just one.
- Build 'time off' into your plan – allow five or ten minutes' break each hour and go out of the room you are in and take some exercise.
- Write up your plan, display it somewhere visible and do your best to stick to it!

Methods of revising

- Reading notes and textbook are important but rarely enough by themselves – this is rather passive revision.
- Make definition lists, bullet points of key factors; write out a summary of existing notes, make spider or mind map diagrams, test yourself using e-versions of multiple choice questions, test yourself with a friend revising for the same subject – these are all active forms of revision.
- Use the 'look, cover, write and check' technique for learning important topics. This involves:

- 1 study the topic for a few minutes
- 2 cover up the book and notes
- 3 write down all you can recall about the topic
- 4 check what you have written against the book and notes.
 - Study your past test and mock examination scripts to identify what went wrong – things to avoid – but also what went right – things to repeat and build upon during the 'real' exam.
 - Practise writing answers to past examination questions – or questions in this book – and either ask your teacher to mark them or check them against the student's answers with authors' comments at the end of each chapter.

Last minute tips

- Don't leave all your revision to the last minute!
- Use your summary notes, checklists, definitions sheets, spider diagrams etc., to check final facts and understanding.
- Sleep well – do not stay up all night trying to cram in yet more knowledge! It's more important to get a good night's sleep before any examination.

TIP

Use the Student CD-ROM in the *Cambridge International AS and A Level Business Coursebook* published by Cambridge University Press (Stimpson/Farquharson ISBN 9781 107677364) as it has many multiple choice questions and mind maps to aid your revision.

Examination skills

How can you use the skills and knowledge you have been building to perform to your best abilities in examination?

The answer to this question is: show the key examination skills in your answer that are relevant to the question set.

What is meant by ‘examination skills’?

They are also known as ‘assessment objectives’ which means the ways in which an examiner will assess or mark your answer. Your answers need to demonstrate the following:

Knowledge with understanding

This means, does your answer contain accurate and relevant Business subject knowledge which shows understanding of the part of the course that is being examined? **All** of your answers must contain evidence of relevant knowledge. One way of showing knowledge is to accurately define the Business term used in the question. So, if the question asks: ‘What is meant by the term “price skimming”?’ then a full and accurate definition of this term will help.

Even if the question is a more challenging A Level question, for example as found on the Cambridge Paper 3 Case Study, then a definition can be an excellent way to start an answer – and demonstrate knowledge in the first sentence! For example: ‘Evaluate a marketing plan for the successful launch of Product X in your country’.

A definition of ‘marketing plan’ would help you show good subject knowledge and it would also direct you to what factors to include in the rest of the answer! However, the most effective way to show knowledge is through its appropriate use.

Application

This skill requires you to make a clear link between your answer and the business in the case study (Example: Cambridge Papers 2 or 3) or in the stem of the question (Example: Cambridge Paper 1). A ‘clear link’ does not just mean mentioning the name of the business or the names of the owners/directors of the business. True application of an answer means that, for example, your knowledge and understanding are being used to analyse the problems **this** business may be facing or how an important decision will impact on **this** particular business.

For example, if the question is: ‘Analyse the advantages and disadvantages of the piece rate system of payment for cooks in Jamie’s restaurant’, then an example of part of an answer which is **not** applied would be: ‘The piece rate system encourages faster working by employees and this may reduce the quality of the finished product’. This argument could apply to **any** business, not just a restaurant.

Here is an example of part of an answer that **is** applied:

‘If cooks are paid piece rate then they may concentrate on preparing meals too quickly so food may not be cooked properly causing customers to complain’.

Application is a very important skill to demonstrate in Business examinations as different businesses will respond in different ways to problems or ways of resolving them or be affected in different ways by external events. Without demonstrating this skill of application you will lose about 25 per cent of the total marks but, in addition, you are likely to lose more marks because the skill of evaluation can usually only be shown by answering in the context of the business.

Analysis

This skill requires that answers contain more than just knowledge. Analysis can be demonstrated in several different ways in answers to Business questions. For example:

- Using the theoretical concepts and techniques included in the Business course to explain the advantages and disadvantages of a business decision, or to develop consequences of that decision.
- Examining the impact on a business of information provided, for example, economic data or information about competitors’ actions.

- Selecting information presented in different forms, such as graphs, tables and charts, and identifying trends and changes and explaining their impact on a business.
- Drawing together ideas and information.

If the question is: 'Analyse the likely impact on Business B's profits of an increase in its selling prices' then an example of one part of an analytical response would be:

'An increase in prices means that the gross profit margin on each unit sold will be higher, assuming that the costs of making it did not increase too. If the business sells the same amount as before, then total gross profits will rise'. However, this is not contextual yet.

Evaluation

This skill requires students to draw conclusions from the arguments used, make judgements which are supported or make recommendations that are justified by preceding analysis. To be effective – and to earn the marks – the evaluation must be rooted in the context of the business featured in the data or case study – which means the judgement made must be applied to the business.

Before evaluation can be effectively demonstrated, the answer must show evidence of knowledge, application and analysis. Evaluation cannot just 'appear' in an answer without the building up of relevant and applied arguments, based on subject knowledge, to support it. Many examples of questions that require evaluation – and students' answers to them – are contained in this book.

How will I know which skills are being examined?

The 'command words' are the important word or words that appear in a question that indicate to students which skills are being examined. It is very important that you understand these command words so that you do not:

- ✓ waste time developing an answer with examination skills that **are not** being examined in a question
- ✗ throw away marks by not showing evidence of the skills that **are** being examined.

TIP

Questions consist of:

'**Command word**' + **Topic** being examined + **Context** (for example, case study).

Spend time thinking about what each question is asking before writing answers!

These are the main command words that will be used on Business AS and A Level examination papers:

Command words	Skills being examined
State	Knowledge
List	
Define	
What is meant by...	
Calculate for this business...	Knowledge Application
Explain how this business...	
From the data outline...	
Analyse	Knowledge
Explain why...	
Explain the advantages and disadvantages of...	Application
Evaluate	Analysis
Discuss	
Assess	Knowledge
Recommend and justify...	
Do you agree...	Application
	Analysis
	Evaluation

TIP

Spend time analysing questions to decide which is the best way to demonstrate evaluation in an answer. For example: 'Recommend' requires a justified recommendation, 'Evaluate the factors' requires a prioritisation of factors, 'Discuss' requires a balancing of arguments and so on.

Understanding mark schemes

Have you seen examples of mark schemes for the Business examination papers?

TIP

Ask your teacher for examples of mark schemes from past Cambridge examination papers.

Mark schemes are the documents used by examiners to guide their assessment of examination scripts. Although the schemes contain details of the subject knowledge that students are expected to show in their answers, this is not their only purpose. They also give details of the number of marks available for each examination skill – and these are normally divided into 'levels' that denote the quality of the answer. It's demonstration of skills that gets the marks – the higher the skill, the higher the mark!

Keys to examination success – the day of the examination

Assuming you have done your very best during the Business course and that you have followed the revision tips above, what are the best ways to prepare for the examination day itself?

- Check the time of the examination and leave for the exam in plenty of time.
- Take all of the necessary equipment with you – for Business, two black pens (one could run out of ink!), a calculator and a ruler should be sufficient. Your exam centre will want these in a 'see through' plastic case.

- When the exam starts, read the instructions carefully and ask the invigilator if any of these instructions are unclear before you start writing.
- Read through case study material very carefully – do this again after you have read the questions because a hurried start in answering the first question nearly always leads to poor marks if the case study material is not understood and key points from it are not incorporated in your answer.
- Look at the marks available for each question and the 'command' word – these will indicate to you which of the examination skills are being tested. They will also give you an indication of how long to spend on answering each question.
- Divide the total time up – you may need to make a note of this – between the questions in proportion to the marks each one carries.
- Write as neatly as you can. It is recommended that you leave a line between each paragraph and at least two lines between each separate answer.
- Plan answers to the longer questions.
- Answer the question that has been set, not necessarily the one that you want to answer!
- Allow ten minutes at the end to read through answers to correct any glaring errors or to add a key point that has been missed out.

Now that you have read this introduction you are well prepared with important advice on how to face your examinations! However, first, you have to actually do the revision and the remainder of this book will, we hope, make your revision more effective and will help you gain the final grade that you deserve. Good luck in your examinations!

Peter Stimpson

Peter Joyce

Unit I
BUSINESS AND ITS
ENVIRONMENT

Enterprise

Learning summary

After you have studied this chapter you should be able to:

- understand what business activity involves
- understand what 'added value' and 'creating value' mean
- recognise what makes a successful entrepreneur
- assess why enterprise is important to a country
- understand what a business needs to succeed and why some new enterprises fail
- recognise what social enterprises are and how they differ from other businesses.

1.1 Business activity

Businesses aim to meet the needs of customers by using resources to make goods and services that they will buy. These products can be either for final consumers or capital and intermediate goods for business customers. Which resources (factors of production) do businesses need?

- Labour: human effort to produce goods or provide services to customers
- Capital: equipment and machinery
- Land: a location to operate the business from
- Enterprise: risk taking and decision making undertaken by an entrepreneur.

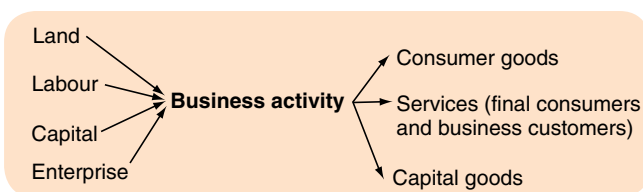


Figure 1.1 Business activity – resources and products

1.2 Opportunity cost

Opportunity cost is an important concept in business activity and business decisions. When a decision is made to purchase one item – for example, a new machine – other items have to be 'given up' as resources are scarce. The loss of benefit that would have been gained from the 'next best' item is called opportunity cost. This applies to decisions made by consumers and governments too.

TERMS

Consumer products (goods and services): bought by 'final' consumers who will benefit from them and not use them to produce other products.

Capital and intermediate goods: goods bought by industry to be used in the production of other products.

Opportunity cost: the benefit of the next most desired option that is given up.

1.3 Added value

Business activity aims to increase **added value**. Increasing 'added value' has many benefits – the key one being that it could lead to higher profits for the owners of the business.

TERMS

Added value: the difference between the cost of purchasing raw materials and the price of the finished good.

Creating value: increasing the difference between the cost of bought in materials and the price finished goods are sold for.

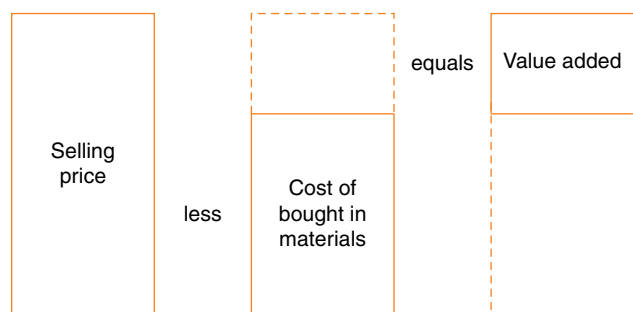


Figure 1.2 Valued added

Ways of adding more value to raw materials include:

- 1 Raising the selling price but keeping the raw material costs constant **but** will customers still buy?
- 2 Purchasing cheaper raw materials but keeping selling prices the same **but** will customers notice a reduction in quality?
- 3 Using raw materials more efficiently so the cost per item falls **but** this might need more accurate machines or more highly trained staff.

1.4 Entrepreneurs

The role and characteristics of successful entrepreneurs

Entrepreneurs are people who are determined to create their own business – not work as an employee for another firm. This means they must have:

- a business idea
- some savings to invest
- willingness to take risks and accept responsibilities.

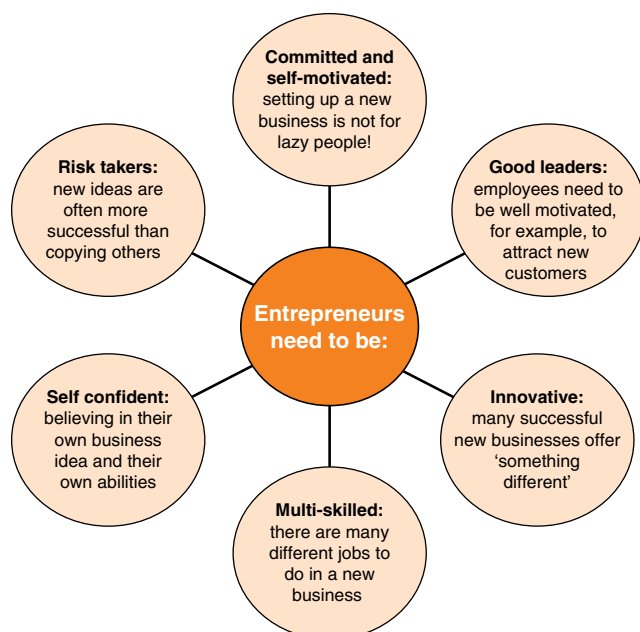


Figure 1.3 Characteristics of successful entrepreneurs

TERM

Entrepreneur: someone who takes the financial risk of starting and managing a new business venture.

Progress check A

- 1 What capital equipment would a hairdressing business need?
- 2 Where is an entrepreneur likely to locate a new shop selling mobile (cell) phones?
- 3 What types of workers would an entrepreneur operating a road transport business most probably need to employ?
- 4 A business making clothes has managed to use ten per cent less material on each item of clothing by using a new cutting machine. Explain what will happen to the 'value created' by this business.
- 5 Explain how a computer could either be sold as a 'consumer good' or a 'capital good'.

1.5 What do businesses need to succeed and why do many new businesses fail?

Business success requires:

- Adequate factors of production
- Customers
- Suppliers
- Government – to provide a legal framework, infrastructure and education.

These are the most common reasons for new enterprises not succeeding:

- 1 Lack of finance or working capital – often difficult to encourage people or banks to invest in new business ideas.
- 2 Lack of record keeping – not having sufficient information to operate the business.
- 3 Poor management skills – even the hardest working and most enthusiastic entrepreneur needs basic management skills, for example, communication and leadership skills.

- 4 Competition – most new enterprises are small and compete against larger rivals who may try to 'squeeze them out of business'.
- 5 A dynamic business environment – economic or technological changes can be a serious problem for new small businesses as they often do not have the resources to respond to them effectively.

Progress check B

- 1 Why are leadership skills important to an entrepreneur?
- 2 Why is it often important for an entrepreneur to be prepared to be a 'risk taker'?
- 3 Why might an 'entrepreneur's innovation' be important for the success of a new business?
- 4 Explain why a new business might fail even though the entrepreneur who set it up has all of the 'key characteristics' listed above.

1.6 Benefits for the entrepreneurs' countries

Entrepreneurs' new businesses give economic benefits to a country. These include:

- Reduce unemployment.
- Increase national output – some could be exported to earn foreign currency.
- Create additional competition for existing firms.
- Increase government tax revenue.
- Innovate and accept technological change.
- May develop and expand into huge corporations!

1.7 Social enterprises

It is wrong to assume that 'all businesses want is to make profits'. This is too simple – as Chapter 4 shows. Good examples of business organisations that try to achieve non-profit based objectives are '**social enterprises**'. Many cooperative organisations are operated as social enterprises (see Chapter 2).

The 'triple bottom line' of social enterprises means that they aim to achieve:

- 1 Economic objectives – making profits to reinvest.
- 2 Social objectives – supporting disadvantaged groups such as providing work for disabled workers or providing support for refugee groups.
- 3 Environmental objectives – managing the business in an environmentally sustainable way.

TERM

Social enterprise: business with mainly social objectives that reinvests most of its profits into benefiting society rather than maximising returns to owners.

TIP

Do not confuse social enterprises with charities – social enterprises will aim to make a profit but will try to do so in an environmentally and socially responsible way.

Progress check C

- 1 Explain **two** reasons why most countries' governments are trying to increase the number of new enterprises in the economy.
- 2 Why might a social enterprise find it easy to recruit well motivated staff?
- 3 Does a social enterprise need profits?
- 4 What other objectives might a social enterprise have apart from making a financial return?

TIP

When a question asks you to 'discuss' you must make sure that you weigh up several possibilities and draw a conclusion in your answer – this will demonstrate the skill of evaluation.

Exam-style questions

Paper 1 Section B

- 1 a Explain the importance of business activity to a country. [8]
- b Discuss the characteristics an entrepreneur needs to set up a successful new retail business. [12]

Student's answer to 1(b)

An entrepreneur is a person who is prepared to take risks in setting up and managing a business, often with their own savings or capital.

Such a person needs to have several personal characteristics if they are going to set up a successful business. They will have to be prepared to work hard as there will be so much to do. Plans will have to be made, a location needs to be arranged, inventory bought and, if the shop is going to be big enough, workers will have to be employed. If an entrepreneur is lazy the retail business is unlikely to succeed.

The entrepreneur will need to be good at making decisions. As there are already so many shops the entrepreneur will need to make the new retail store 'stand out'. Perhaps unusual products will be sold to attract customers or the location of the shop might be really important. If it was a shop selling sandwiches and drinks then locating it near where many people work would be a good idea. If the entrepreneur is not good at making decisions, the shop will fail.

The entrepreneur will need people skills too. This means they will need to be able to get on well with customers and workers. If they are bad leaders

and shout at workers in front of customers in the shop then this will lead to customers leaving. If they cannot talk to customers to find out what they really want then the shop may end up selling the wrong products.

Perhaps the most important characteristic that the entrepreneur must have is to be multi-skilled. They will have to be good at numbers to do the accounting and check the inventory. They need to know about the product they are selling. They will need to know about displays and presentation. As the business is new and small the owner will not be able to afford to employ people to do all of these things which is why multi-skilling is so important.

So, a successful entrepreneur must have many characteristics to succeed in retailing. However, even all of these might not be enough to make sure the business is successful if there is a recession or if customer tastes change quickly.

Authors' comments

This is an excellent answer. It demonstrates knowledge as entrepreneur is defined and good awareness of personal characteristics is shown. Can you also see that the answer is applied to retailing? This is very important – the student tries to make points that are particularly relevant to setting up and running a shop. The points made are well explained or analysed and there is good judgement or evaluation. The evaluation is strong in two ways. The student suggests and justifies the 'most important characteristic' and also looks briefly at other factors, apart from the entrepreneur, that could affect the success of a shop.

Additional exam-style questions

Paper 1 Section A

- 1 Explain the term 'creating value'. [3]
- 2 Explain why opportunity cost results from the decision by a business to purchase a new vehicle. [3]

Paper 1 Section B (essay)

- 3 a Explain the main features of social enterprises. [8]

- b Discuss the most likely reasons why some new enterprises fail in the first year of operation. [12]

Paper 2

Linda's Pottery

- 4 Linda decided three months ago to set up her own business. She has been told that she has enough enterprise to make a success of her new business idea – a pottery making plates and bowls. After leaving her office job she spent



some of her savings to obtain essential factors of production. In the first three months of trading she recorded the following figures:

Plates sold, 50 – average price \$4

Bowls sold, 120 – average price \$3

Cost of bought in materials used – \$280

Linda wants to create more value. She is planning either to increase prices by ten per cent or cut the cost of the materials she buys in – mainly clay and paints.

There are several pottery businesses in her region and some of them claim to sell the best quality plates and bowls.

Although Linda is a skilled potter she has never gained any management experience. She is

prepared to spend a lot of time learning how to operate her business successfully.

- a i Define the term 'enterprise'. [2]
- ii Briefly explain the term 'factors of production'. [3]
- b i Calculate the added value of Linda's business in the first three months. [3]
- ii Explain one reason why 'added value' is important to Linda. [3]
- c Analyse **two** of the characteristics that Linda will need to reduce the chance of her new business failing. [8]
- d Recommend to Linda which method of creating added value she should choose. Justify your answer. [11]

Learning summary

After you have studied this chapter you should be able to:

- understand the different levels of business (economic) activity and the difference between private sector and public sector
- understand limited liability and its importance
- understand legal forms of business organisation and their main differences
- assess the factors that influence the most appropriate form of business organisation
- understand the problems of changing from one legal structure to another.

2.1 Economic activity

It is common to divide business activity into three sectors. The relative importance (as a percentage of total national output) of these varies greatly between countries. Generally, it is true that in high income developed economies, such as France, the **tertiary sector** is the most important. In middle income emerging economies such as Brazil and China, the **secondary sector** tends to be the most important. In low income developing economies the **primary sector** is often the most significant. This helps to explain the low average incomes in these countries – the value added by the primary sector is usually much lower than that of the other two.

TERMS

Primary sector: businesses involved in farming, fishing and extracting natural resources.

Secondary sector: businesses involved in manufacturing products from primary goods.

Tertiary sector: businesses involved in providing services to consumers and other businesses.

2.2 Private sector and public sector

Private sector businesses are often operated with the objective of earning profits. **Public sector** organisations – such as police force, schools, universities and hospitals –

have other objectives. These could include social aims, such as caring for the elderly, or keeping law and order.

Nearly all economies have a 'mixture' of these two sectors and are referred to as mixed economies. If there was no public sector activity it would be called a free-market economy. If there was no private sector, it would be called a command or a planned economy.

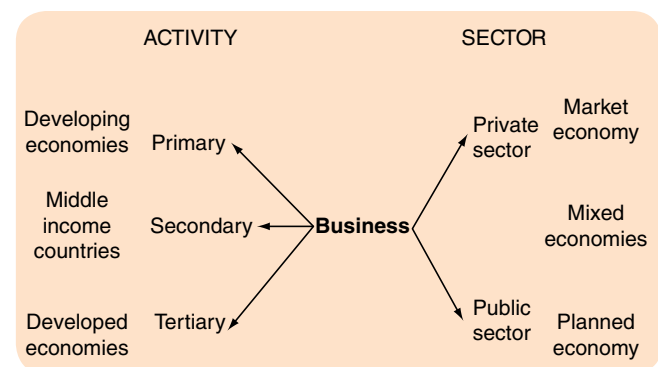


Figure 2.1 Economic activities and economic systems

TERMS

Private sector: comprises businesses owned and controlled by individuals or groups of people.

Public sector: comprises organisations owned by, accountable to and controlled by the state.

Limited liability: investors/shareholders are only liable (can only lose) for their original investment in a company.

Progress check A

- 1 Research (using the internet) the share of the total economy accounted for by the private sector in any two countries of your choice.
- 2 Would you classify a business that roasts and grinds coffee beans as being in the primary or secondary sector of industry?
- 3 Explain one reason why the tertiary sector is often much more important in developed economies than in developing economies.
- 4 Is the private sector more or less important than the public sector in your economy?
Use employment or output data to help you answer.

2.3 Legal forms of business organisation

	Sole trader	Partnership	Private limited company	Public limited company
	A business owned and controlled by one person	A business owned by two or more people sharing investment and responsibilities	A business owned by shareholders, often family members, which cannot sell shares to general public	A business, owned by shareholders, which has the right to sell shares to general public
Ownership	One person	Shared between partners	Shareholders (but shares not available publicly)	Shareholders (general public or investment/pension funds)
Senior managers	The owner	One or more of the partners	Usually one of the main shareholders but can be a professional manager	Professional directors elected by shareholders – CEO appointed by Board of Directors
Financial liability	The owner	Shared by the partners – except in case of limited partnership	Limited to the amount invested by shareholders	Limited to the amount invested by shareholders
Main capital sources	Owner's savings Bank loans	Partners' savings Bank loans	Capital from sale of shares Retained profits Bank loans	Capital from sale of shares Retained profits Bank loans
Common problems	Lack of management skills Lack of capital for expansion Unlimited liability	Some partners may be more competent or harder working than others Unlimited liability Profits shared	Some loss of control/ownership when the original owner sells shares to friends/business contacts Cannot sell shares to general public Legal formalities Some disclosure of accounts	Further loss of control/ownership by original owners Divorce between ownership and control Full disclosure of accounts as legally required

	Sole trader	Partnership	Private limited company	Public limited company
	A business owned and controlled by one person	A business owned by two or more people sharing investment and responsibilities	A business owned by shareholders, often family members, which cannot sell shares to general public	A business, owned by shareholders, which has the right to sell shares to general public
Common benefits	Owner keeps all profits Owner takes all decisions – no need to consult with others which can be time – consuming	More capital invested by partners Sharing of responsibilities Often partners have different skills and experience	Limited liability for shareholders Less disclosure of accounts than public limited company Continuity	Limited liability for shareholders – this makes it easier to attract new shareholders who can now include the general public Access to more capital through sale of shares via Stock Market Continuity
Most likely to be appropriate for	One person business owned by an entrepreneur wanting to keep control and not expand the business	The owner wants to expand business by taking on partner with capital – able to share responsibilities	Owners want the security of limited liability, want to raise funds by sale of shares and status of separate legal entity	Owners want to raise large sums of capital for substantial business growth Prepared to risk some loss of control

Table 2.1 Types of business organisation

TIP

There is no one correct or appropriate form of legal structure or business organisation – it depends on the size and nature of the business and the objectives of the owners.

2.4 Other business structures

Cooperatives

These can offer the opportunity for members to gain from bulk buying and the incentive to operate the **cooperative** efficiently as all will benefit from higher profit.

Decision making can be slow if all members have to be consulted.

TERM

Cooperatives: all members/owners can contribute to the running of the organisation and profits are shared between them.

Franchise

An entrepreneur might decide to take out a **franchise** of an existing successful business to reduce risks, to receive advice and training, to gain a reliable source of supplies and benefit from a well-established brand. However, this business model will reduce the entrepreneur's independence and there will be franchise fees to pay plus, probably, a share of the sales or profits to the franchisor.

TERM

Franchise: a business that uses the name, logo and trading systems of an existing business.

Joint venture

This structure is particularly common when expanding abroad as local knowledge can be gained through a **joint venture** with a firm based in the country.

Different leadership/management styles and clashes of culture can lead to problems with these ventures.

TERM

Joint venture: two or more businesses agreeing to work together on a particular project. This allows risk and costs to be shared although it might lead to disputes over leadership.

2.5 Problems of changing legal structure

- Cost – it can be expensive to create a limited company or to arrange the public sale of shares to convert a private company into a public limited company.
- Loss of control – taking on a partner, selling shares to new shareholders or converting a private company into a public limited company all involve some loss of control over business decision making.
- Sharing of profits – by taking on additional owners, profits have to be shared between more people.

Progress check B

- 1 List **two** types of business organisation that do not give their owners limited liability.
- 2 Why is 'shareholders' limited liability' important to a public limited company when it advertises its shares for sale?
- 3 Why might a sole trader decide **not** to take a partner into the business?
- 4 Why might the directors of a private limited company decide **not** to convert the business into a public limited company?
- 5 Differentiate between a joint venture and a franchise.
- 6 Explain why the managers of a retailing business might choose to expand the business through franchising.
- 7 Explain why a business planning to operate in a foreign country for the first time might decide to establish a joint venture there.
- 8 Why is limited liability important to someone planning to invest in a business?
- 9 Explain **two** problems to the owners of a private limited company of converting the business to a public limited company.

Exam-style questions

Paper 1 Section A

- 1 Discuss whether a new entrepreneur who wishes to set up her own café should take out a franchise with a well-established international café company. [20]

Student's answer

A franchise means that the business buys a licence from a franchisor to operate the business under the name of the franchisor. The franchisee would use the logo/brand name of the franchisor and would usually sell all of the products/services supplied by this business too.

The question states that this is a new entrepreneur which means that she might not have much business

experience. Operating as a franchise means the franchisor will provide training, advertising, advice on products and pricing and other issues which means that the new entrepreneur has a greater chance of avoiding important mistakes. Also, using the name of a well-established business means that customers of the café will already know the name, products and image of the business, making the launch of the new enterprise less risky. The food and drinks sold by the franchisee will already be 'tried and tested' and the entrepreneur will not have to make decisions about these products.

New entrepreneurs do not usually have much finance so the cost of the franchise licence may be too expensive and leave too little money for employing workers or for buying or leasing the premises. This could be the most important reason

why the new entrepreneur might decide to just set up her own café under her own name. Also, she probably wants to be independent – this is an important reason why many people set up their own business. The franchisor will insist on taking many decisions and will also demand a share of revenue or profits. For an independent minded person this level of control might be too much.

There are many factors for the new entrepreneur to consider before making this important decision. Operating a café is not as difficult as, say, setting up a car factory and the machinery and materials used are relatively easy to work with. The brand name of a large franchisor could also be damaged, e.g. by a food poisoning scare in another café. For this reason,

I think most new entrepreneurs planning to start a new café would not take out a franchise – but much will depend on how much capital they have and how much risk they are prepared to take.

Authors' comments

This is a well-planned and clearly written answer. Can you see the clear references to 'new entrepreneur' and 'café'? – these help to apply the answer firmly in the context given by the question. There is some good analysis of both the advantages and disadvantages of franchising. There is clear evaluation – not only in the final paragraph but also when the student assesses the 'important reasons' and explains these well.

Additional exam-style questions

Paper 1 Section A

- 1 a Explain the term 'sole-trader business'. [3]
- b Explain why a sole-trader might take on a partner. [3]

Section B

- 2 a Explain why the concept of limited liability is important to both shareholders and limited companies. [8]
- b Discuss whether a retailing business that plans to set up operations for the first time in a foreign country should establish a joint venture with a retailing company in that country. [12]

Paper 2

Spanish Minerals Ltd. (SML)

'I do not see how we are going to compete with ROC Incorporated', said Joe Sainz, the managing director and main shareholder of SML. This is a private limited company that extracts minerals from three quarries in Spain. 'As one of the largest public limited mining companies in the world, ROC Inc's decision to start up operations in Spain by opening a huge new quarry could force us out of business! We operate in the private sector and have no government support.'

'We have capital saved from retained profits and we could consider conversion to a public limited company', said the other main shareholder of SML Pablo Massa. 'With the capital raised we could aim to become a highly mechanised and efficient supplier of high grade minerals. If the sale of shares was successful, we could also become very rich!'

'Perhaps', Joe replied, 'we should focus on our cement factory which uses some of the minerals we extract. If we concentrated on processing minerals rather than mining them, we could use ROC as one of our suppliers or even form a joint venture with the company'.

- 3 a i Define the term 'private limited company'. [2]
- ii Briefly explain the term 'private sector'. [3]
- b Using examples from the text, explain the difference between primary sector activity and secondary sector activity. [6]
- c Analyse the reasons why SML might gain from forming a joint venture with ROC. [8]
- d Evaluate whether Joe and Pablo should convert SML into a public limited company. [11]

Size of business

Learning summary

After you have studied this chapter you should be able to:

- understand ways of measuring business size
- recognise benefits of small firms for an economy
- understand the advantages and disadvantages of small and large businesses
- explain why and how a business might grow internally
- recognise the benefits and limitations of family businesses.

3.1 Measuring business size

Why is it important to know 'how big' a business is or 'how many' small businesses there are in a country? Business managers and governments are interested in measuring business size. For example:

- Managers want to know if their business is becoming relatively larger than others in the industry.
- Governments want to know if national businesses are becoming larger compared to those of other countries – and whether the number of small businesses is increasing.

None of the measures of business size is perfect. In some cases they can give rather misleading indications of business size – which is why it is common to use more than one measure to make comparisons between businesses.

Some of the problems include:

- **Market capitalisation:** would exclude IKEA, Virgin and other large private limited companies. The market capitalisation values can also change greatly with a Stock Market 'boom' or 'slump'.
- **Employment:** this would make a nuclear power company – with relatively few employees but huge capital investments – appear quite small.
- **Capital employed:** this would make a labour intensive industry – such as a postal service – appear quite small compared to the large number of people it employs.
- **Sales value:** although useful for making comparisons between firms in the same industry, it is of limited value in making inter-industry comparisons.
- **Market share:** useful for making comparisons between the relative importance of firms in

the same industry, it is of no use in making size comparisons between firms in completely different industries.

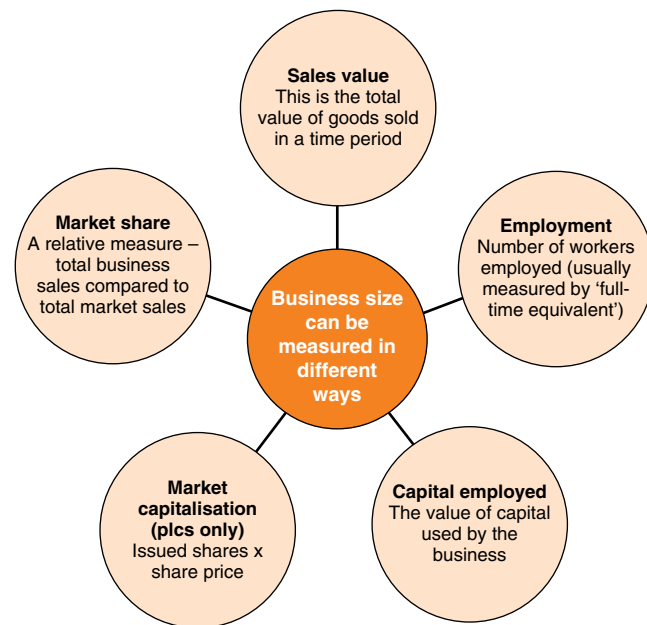


Figure 3.1 Measuring business size

TIP

All measures of size have shortcomings. It is best to use a measure in the context of an industry/sector and over time.

The level of profit made by a business is *not* a good measure of size. It may be a useful indicator of performance/effectiveness but not size.

Progress check A

- 1 Company A is a construction business employing 100 part-time workers who, on average, work 20 hours per week. Company B is a construction business employing 30 full-time workers (40 hours per week, on average). Which company is larger (using the employment measure)?
- 2 Why would it be misleading to compare the size of an electricity generating business with that of an office cleaning business using the 'capital employed' measure?
- 3 Why would it be impossible to compare the size of two sole trader businesses by using the 'market capitalisation' measure?
- 4 Explain whether 'sales value' is a good way of measuring the size of two car manufacturing businesses.

3.2 Small firms can benefit an economy

Most governments are willing to offer special support for small businesses because of the economic benefits they offer:

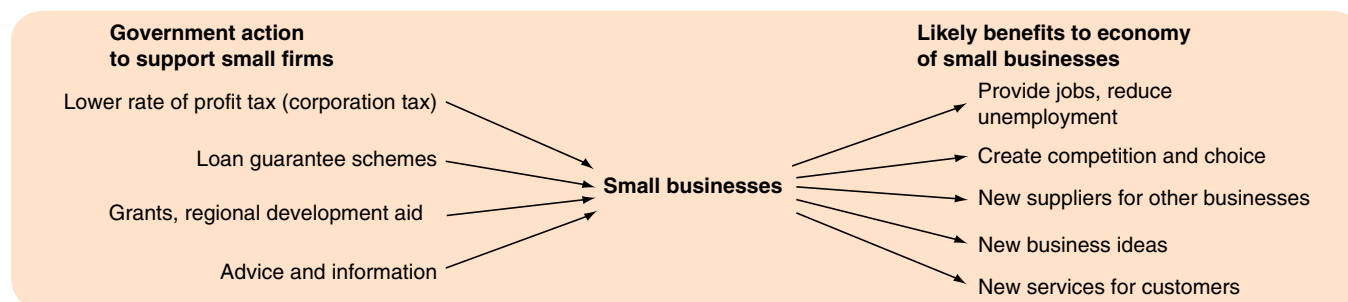


Figure 3.2 Small businesses – government support and economic benefits

3.3 Common strengths and weaknesses of family businesses

Feature of family business	Common strengths	Common weaknesses
Structure	Informal, flexible, entrepreneurial, innovative.	Resistant to change, lack of management development, no organisation charts – unclear structure.
Roles	Family members often play multiple roles, flexible, quick decision making.	Role confusion, jobs do not get done, family favouritism can lead to unqualified family members in jobs.
Leadership	Creative, ambitious, informal authority, entrepreneurial.	Autocratic, resistant to new ideas, avoids delegation.
Employees including family members	Employees often committed and loyal, shared values and culture.	Cannot keep family issues out of business, inability to balance family's and business's needs, inward looking, can't separate work and family, family rivalries.



Feature of family business	Common strengths	Common weaknesses
Succession	Training successors can begin early, can choose when to leave.	Family issues get in way, unwillingness to let go, unwilling to choose a successor.
Ownership/control	Closely held, family owned, high degree of control, earnings are motivators.	May sacrifice growth for control, often no outside directors, need for privacy.
Culture	Innovative, informal, flexible, creative, adaptable, common language, efficient communications.	Founder's role can stifle innovation, inefficient, emotional, resistant to change, high risk of conflicts.

Table 3.1 Family businesses – strengths and weaknesses

3.4 The relative advantages and disadvantages of small and large businesses

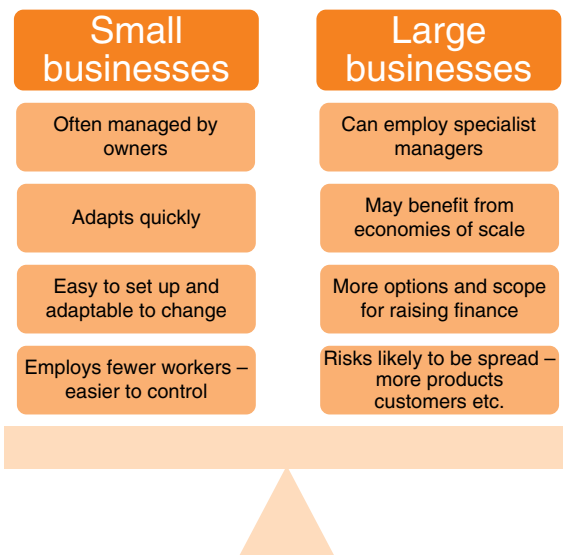


Figure 3.3 Advantages of small businesses compared with advantages of large business

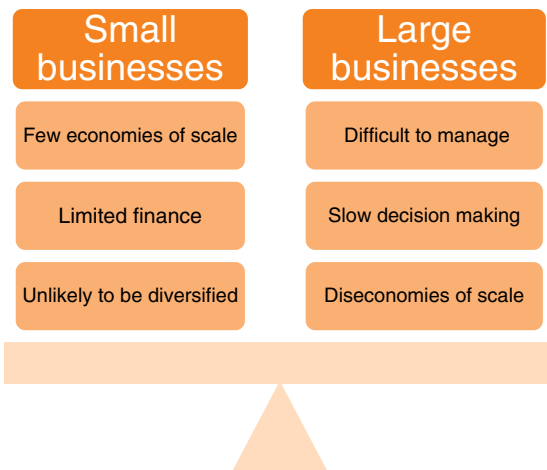


Figure 3.4 Disadvantages of small businesses compared with disadvantages of large businesses

Progress check B

- 1 Research the support given by the government in your country to small businesses.
- 2 Explain **two** problems often faced by small businesses.
- 3 Explain **two** problems that often result from managing a large business.

3.5 How businesses grow

Many owners and managers of businesses want their firm to expand. Some do not – and the reasons for different business objectives are considered in Chapter 4.

Business expansion can take place in two ways:

- 1 **Internal growth** (or organic growth) through expanding existing operations and opening new ones e.g. Apple developing new products or ZARA opening more shops.
- 2 External growth through integration with another business (see Chapter 7).

TERM

Internal growth: expansion of a business by means of increasing sales and opening new branches, shops or factories – also known as organic growth.

TIP

Remember that internal growth is often easier to manage than sudden external growth.

Exam-style question

Paper 1 Section A

- 1 Define the term 'internal growth'. [2]

Student's answer

Expansion of a business that comes from increasing sales due to opening new branches/shops/factories.

Author comment

This is a good answer to this question.

Additional exam-style questions

Paper 1 Section A

- 1 a State **two** ways in which business size can be measured and compared. [2]
- b Explain one reason why small businesses are commonly found in the hairdressing industry. [3]

Section B

- 2 Analyse the possible weaknesses of family businesses. [8]
- 3 Discuss the importance of small firms to the economy of a country. [12]

Paper 2 (part question)

Joe Trading (JT)

Joe started JT 25 years ago with capital of \$1000. JT's accountant now values the capital employed

at \$12.5m. Joe believes that JT is now one of the largest retailers of sports equipment in the country. JT operates 35 shops, all leased from property companies at very competitive rents. Joe thinks the main reasons for JT's success are his commitment to the business and low prices. 2 years ago Joe passed overall control of the business to Liam, his son. He had just graduated from university with a Business degree. Some JT workers have recently left the business because of Liam's different approach to management, compared with Joe. Liam has appointed his sister as Marketing Director. She is keen to do well but admitted to a friend that she was not really interested in sport.

- 4 Analyse two benefits to JT from being 'one of the largest retailers of sports equipment in the country'. [8]
- 5 Discuss whether the future success of JT will depend mainly on it remaining a family business. [11]

Business objectives

Learning summary

After you have studied this chapter you should be able to:

- understand why it is important for a business to set objectives at corporate, departmental and individual levels
- explain different stages of business decision making and the role of objectives in decision making
- understand the links between mission statement, objectives, strategy and tactics
- explain the factors that determine business objectives and why objectives might change over time
- explain corporate social responsibility as an objective and the importance of ethics when setting business objectives.

4.1 Why should businesses set objectives?

An objective is an aim or target for the future. If businesses do not have objectives then:

- there is no sense of direction or focus for the management team or employees
- employees in the organisation do not know what they are aiming to achieve
- there is no way of assessing 'success' or 'failure'
- investors will not be keen to invest in the business as it is unlikely to have a clear future **strategy** – because there is no clear objective.

Having set objectives, senior management must communicate them to stakeholders for them to have any impact on employees, investors, customers and other groups.

4.2 Why should objectives be SMART?

Consider this statement by a company Managing Director:

'Our company should aim to become bigger in the future and dominate the market we sell our products in'.

Is this a clear and effective **corporate objective**?

TERMS

Strategies: long-term plans to achieve objectives.

Corporate objectives: specific goals set for the business to achieve.

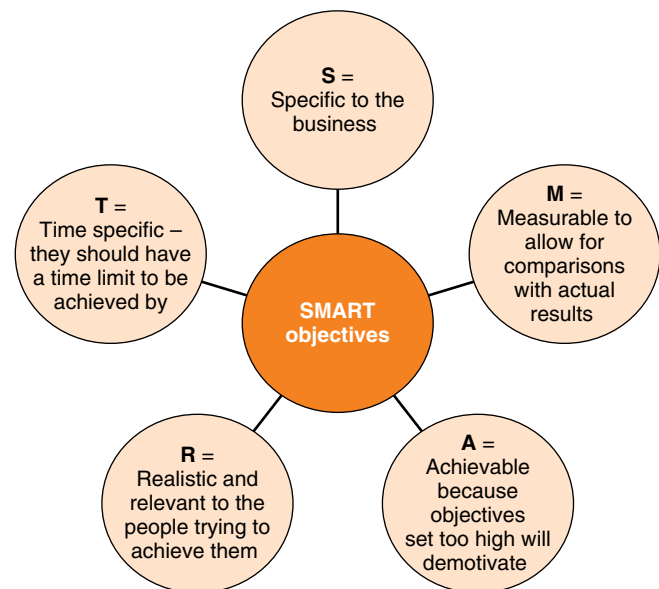


Figure 4.1 SMART objectives

Progress check A

- 1 Explain why the objective: 'Our company should aim to become bigger in the future and dominate the market we sell our products in', is not SMART.
- 2 Explain **two** benefits to an entrepreneur of setting clear objectives for a newly formed business.
- 3 Give an example of a SMART objective that a large business might set.
- 4 Explain **two** benefits to this business of the objective being 'measurable'.
- 5 Explain how the workers in a business might react if the firm had no clear objectives.
- 6 Give an example of an 'unrealistic objective' for a small shop selling food and drinks.

TIP

Effective objectives should be SMART (see Fig 4.1).

TERMS

Corporate aim: long-term goal of the business.

Mission statement: statement of the business's core aims and purpose.

Divisional/departmental objectives: the specific objectives of each division or department of the business, based on the corporate aim and objectives.

4.3 Linking mission statements, objectives and strategies



Figure 4.2 Hierarchy of objectives

TIP

Remember, without a clear objective, developing effective plans of action or taking strategic decisions will become almost impossible.

Advantages	Disadvantages
<ul style="list-style-type: none"> • Tells stakeholders what the business 'is about'. 	<ul style="list-style-type: none"> • It can be very general and just 'wishful thinking'.
<ul style="list-style-type: none"> • The process of creating a mission statement can help bring managers together. 	<ul style="list-style-type: none"> • It does not provide SMART objectives for use within the business.
<ul style="list-style-type: none"> • It provides a sense of purpose to managers and workers. 	<ul style="list-style-type: none"> • It may need to be revised frequently if the nature of the business changes.

Table 4.1. Mission statements - advantages and disadvantages

Further points:

- 1 Once a corporate objective(s) has been established the senior management of a business will then focus on developing strategies to achieve this objective.
- 2 Corporate objectives should not be 'set in stone'. They may need to be adapted or changed completely over time. For example:
 - i Once a newly established firm has 'survived' the first crucial few months of operation the owner may seek to expand the business or aim to achieve high profits.
 - ii Major changes to the external environment – such as an economic recession – might result in objectives for business growth being changed to aiming for survival.

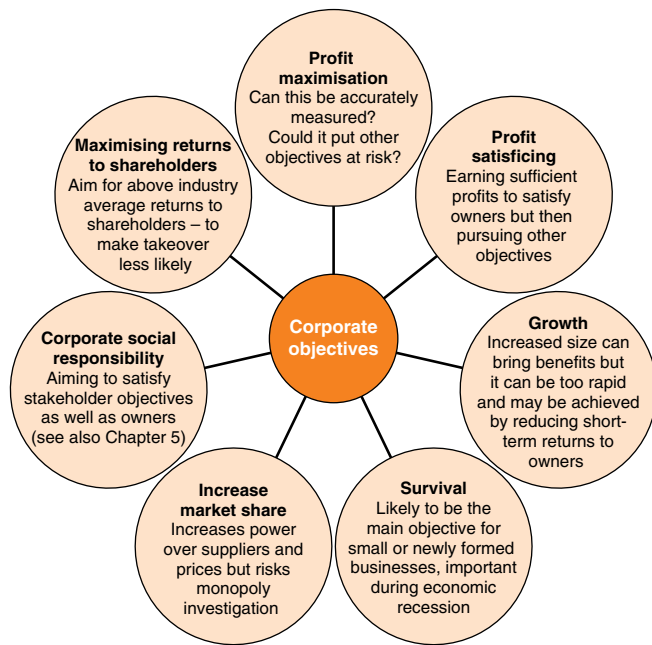


Figure 4.3 Corporate objectives

TIP

Never confuse an objective with a strategy in your answer. An objective is what a business is trying to achieve – a strategy is the means used to achieve it.

For example, expanding the company into another country might be the strategy used to meet the objective of higher shareholder returns in the long run.

Progress check B

- 1 'We intend to make our products the best known computers in the world'. Do you think this is an objective or a mission statement? Explain your answer.
- 2 Explain why the objectives set for the marketing and finance departments of a car manufacturing business should be based on the company's overall objectives.
- 3 Would you advise an entrepreneur to spend time on developing a well thought out mission statement? Explain your answer.
- 4 Explain one reason why a business might change its objectives over time.

4.4 Objectives and decision making

Clear objectives are essential for effective business decision making. Objectives should be at the centre of the decision-making process (see Fig 4.3).

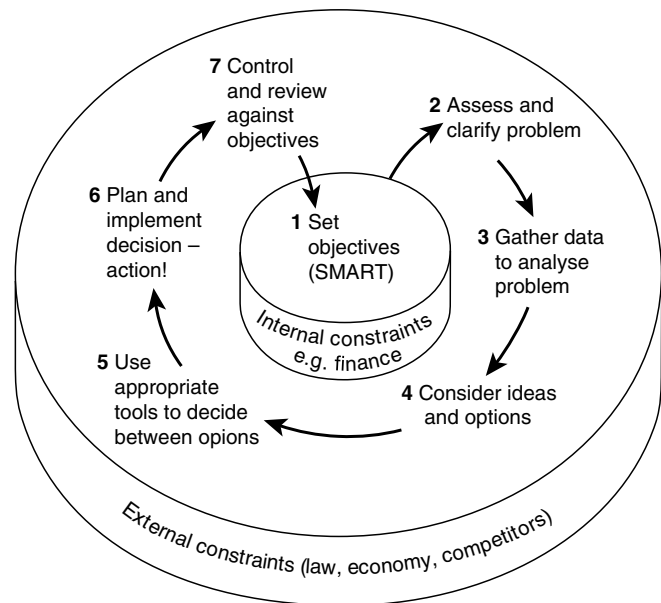


Figure 4.4 Corporate objectives at the centre of the decision-making cycle

4.5 Factors influencing corporate objectives

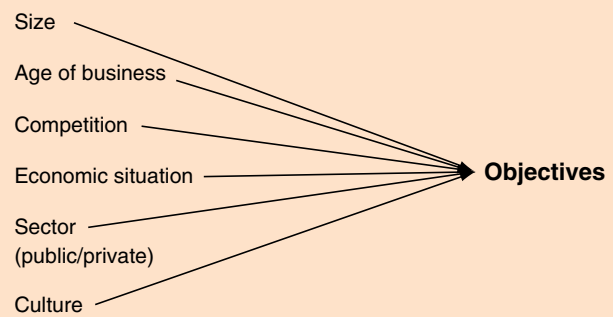


Figure 4.5 Influences on business objectives

4.6 Potential conflicts between objectives

Conflicts can occur in a number of different ways:

- 1 Maximum sales growth might conflict with a profit objective – selling **more** does not necessarily mean **higher** profits.
- 2 Between short-term objectives and long-term objectives – investing capital for long-term expansion may conflict with short-term profit objectives.
- 3 Stakeholders objectives often conflict (see Chapter 5).

4.7 Ethics – should business objectives reflect ethical standards?

Should business decisions be influenced by just profit calculations – or should moral issues be considered too? This is one of the big debates in global business today. Should managers be allowed to:

- advertise directly to children?
- employ very young workers?
- pay workers as little as possible?
- pollute the environment if it is not illegal to do so?
- pay bribes to gain extra orders?

TERMS

Ethics: moral guidelines that influence decision making.

Ethical code: a document detailing the rules and guidelines on staff behaviour that must be followed by all employees of an organisation.

The arguments for and against ethical decisions are:

For

- May give business positive publicity
- Attracts customers who are ethically minded
- Attracts employees who want to work for an ethical business
- Avoids breaking laws and the consequences of this.

Against

- May add to business costs, for example, paying workers above 'poverty wages'.
- May make the business uncompetitive if other firms in the industry are not acting ethically.
- Sales may be lost if bribes are not paid.
- Most customers want low prices and are not worried about how products are made or how workers are treated.

Most businesses have an **ethical code**. This can be used as a guide to all employees as to what behaviour is and is not acceptable in that business. However, if workers or managers are paid large bonuses for 'outstanding sales or profits', might they be tempted to break the ethical code to try to cut costs or increase sales?

TIP

When discussing a question about ethical issues do not just state your opinion without explaining the business arguments for and against a particular decision.

Progress check C

- 1 Explain why the objectives of a business might change if it was a private limited company but is converted to a public limited company.
- 2 Explain how the economic cycle of boom and recession might influence business objectives.
- 3 Explain why some business analysts think that advertising products directly to children is unethical.
- 4 Suggest **three** statements that might be included in the ethical code of a large oil company.

Exam-style questions

Paper 1 Section B

- 1 a Analyse how the objectives of a social enterprise are likely to differ from those of a privately owned manufacturing company. [8]

Student's answer

An objective is an aim to work towards. Social enterprises are managed by people who want to do good for society and help the environment. For example, they might want to operate a bus service for disabled people. This would help people who would find it difficult to travel. Bus services are more environmentally friendly than other forms of transport. However, social enterprises cannot operate without some income or profit so they also aim to make a financial surplus. So disabled people might be charged for the bus service – or government might provide a payment for each person transported by bus. Usually, any profit made by social enterprises is put back into the organisation to improve services in the future. Profit, people, environment – this is sometimes called the 'triple bottom line' meaning there is more than one objective for social enterprises.

Privately owned companies are often only interested in profit. They may not have any social or environmental aims as often the only 'bottom

line' they are interested in is making money for the owners. This depends on the views and culture of the owners – shareholders of companies – and senior managers. If a manufacturing business has owners and managers who are only aiming for high profit, then it will produce in ways that damage the environment in order to make higher profits. Not all non-social enterprises operate like this. Some may have owners and managers to accept some social responsibility. They will not want to damage the environment or endanger their workers even if it means raising costs and reducing short-term profits. Some analysts argue that if a privately owned business acts socially responsibly it could result in higher long-term profits.

Authors' comments

This answer starts off really well. Objectives are defined. There is a very good understanding of social enterprises and their objectives. The student then analyses and compares the objectives of social enterprises with those of a privately owned manufacturing business. This shows good understanding of some of the key differences – and possibly similarities – between these organisations. This is a good essay and time has not been wasted 'showing evaluation' as the command word 'analyse' does not require this skill to be demonstrated.

Additional exam-style questions

Paper 1 Section A

- 1 a What is meant by a 'SMART objective'? [2]
 b Explain briefly why ethics might influence the objectives of a business. [3]

Paper 1 Section B

- 2 a Explain the relationship between mission statement, objectives and strategy. [8]
 b Discuss the extent to which setting clear business objectives will ensure that a book retailing business is successful. [12]

Paper 2 (part question)

Read again the Paper 2 case study in the Additional exam-style questions in Chapter 3.

Liam plans to make JT even more profitable. He has told all workers that making the highest levels of profit will benefit the business and make their jobs more secure. Liam has told his purchasing manager to insist that all suppliers of sports equipment – especially the smaller one who depend greatly on JT's orders – cut the cost of their supplies to JT by 15% or risk losing contracts. He also insists that all new employees should be put on a 12 month trial period before their job is confirmed. Liam has recently met with the country's Sports Minister and told her that "I will make whatever payments are necessary to secure the contract to supply the country's Olympic sports teams".

- 3 Analyse the benefits to JT of having a clear long term objective. [8]
 4 Discuss whether Liam's recent decisions are examples of unethical business practices. [11]

Stakeholders in a business

Learning summary

After you have studied this chapter you should be able to:

- know what a stakeholder is and the main stakeholder groups
- understand the roles, rights and responsibilities of stakeholders
- know about 'stakeholder interests' and how socially responsible firms try to be accountable to stakeholders
- analyse problems caused by conflicting stakeholder objectives
- understand how changing business objectives might affect stakeholders.

5.1 Stakeholders and the stakeholder concept

Most organisations accept, in some degree, the **stakeholder concept** and have moved away from the view that all business decisions must be taken with only shareholders' interests in mind. Why this change?

- Stricter legal controls over business decisions, for example, pollution levels, wage levels, product standards.
- Increasing recognition that business activity should operate in wider interests of society.
- Extensive negative publicity for companies and senior managers who are seen not to be acting in society's interests – and the impact this can have on long run profitability too.

TIP

Careful! Shareholders own shares in limited companies but the term 'stakeholders' has a much wider meaning.

Do not confuse these two terms – and do not forget that shareholders are just one of the many stakeholder groups.

TERMS

Stakeholder: people or groups of people who can be affected by, and have an interest in, any action by an organisation.

Stakeholder concept: the idea that businesses and their managers have responsibilities to many groups, not just shareholders (business owners).

5.2 How stakeholders are affected by business decisions and activities

Businesses have responsibilities to **stakeholders**. For example:

- Customers – good value, safe products, fair competition
- Workers – fair pay, job security, safe working conditions
- Suppliers – payment on time
- Local community – pollution kept to minimum, support for local groups.

Business decisions can affect different stakeholders in different ways. An example of an important strategic business decision that affected many stakeholders was the decision by Burberry clothing to relocate some production from the UK to factories in China. How were stakeholder groups affected? Did Burberry meet stakeholders' objectives?

Progress check A

- 1 What do you think the 'stakeholder concept' of operating a business means?
- 2 Why might the local community be both positively and negatively affected by the opening of a new tyre making factory?
- 3 Under what circumstances could some customers be prepared to accept products of slightly lower quality?

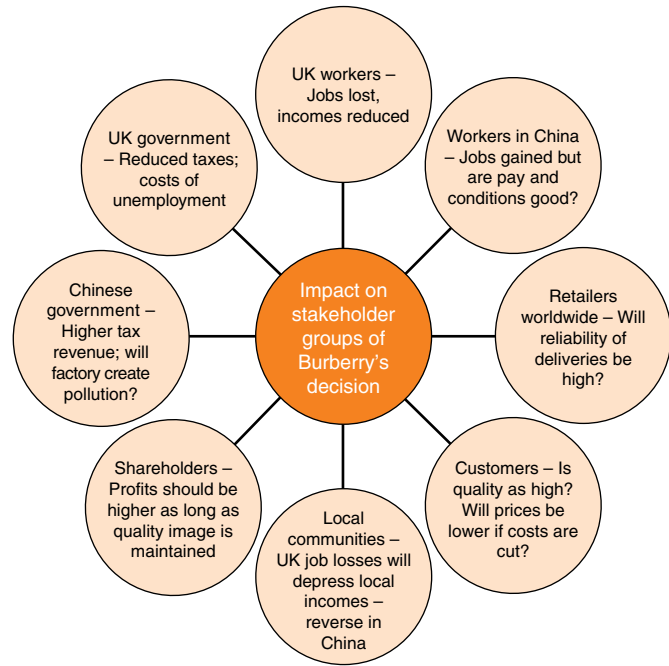


Figure 5.1 Impact on stakeholder groups of Burberry's decision

5.3 Roles, rights and responsibilities of important stakeholders

Stakeholder group and role	Rights	Commonly accepted responsibilities
Customers – buying products provides revenue for business.	<ul style="list-style-type: none"> • Receive goods and services that meet national legal standards. • To be offered replacements, repairs, compensation in the event of failure of the product or service. 	<ul style="list-style-type: none"> • To be honest – to pay for goods bought or services received when requested. • Not to steal. • Not to make false claims about poor service, under performing goods or failed items.
Suppliers – deliver agreed quantity and quality of resources to business.	<ul style="list-style-type: none"> • To be paid on time – as laid down either by law or by the service agreement agreed between the business and suppliers. • To be treated fairly by the purchasing business, for example, not to be threatened with losing big contracts from much more powerful customer businesses. 	<ul style="list-style-type: none"> • Supply goods and services ordered by the business in the time and condition as laid down by the purchase contract or 'suppliers service agreements'.
Employees – work according to agreed conditions of employment.	<ul style="list-style-type: none"> • To be paid at least the national minimum wage. • To be given an employment contract with reasonable terms and conditions. • In most countries, to be allowed to join a trade union if desired. • Increasingly, workers expect to be involved in business activities and to be given opportunities to participate. 	<ul style="list-style-type: none"> • To be honest. • Meet the conditions and requirements of the employment contract. • To cooperate with management in all reasonable requests.



Stakeholder group and role	Rights	Commonly accepted responsibilities
Local community – provide local facilities to business.	<ul style="list-style-type: none"> To be consulted about major changes that affect it, for example, expansion or rationalisation (closure) plans. Not have lives of local residents very badly affected by the businesses' activities, for example, pollution or excessive truck movements. 	<ul style="list-style-type: none"> To cooperate with the business, where reasonable to do so, on expansion and other plans. To meet reasonable requests from business for local services such as public transport (for example, to allow staff to get to work) and waste disposal.
Government – control business activity and provide secure and stable economic/political/legal environment.	<ul style="list-style-type: none"> Businesses have the duty to government to meet all legal constraints such as producing only legal goods, and to pay taxes on time. 	<ul style="list-style-type: none"> Treat businesses equally under the law. Prevent unfair competition which could damage business survival chances. Establish good trading links with other countries to allow international trade.

Table 5.1 Stakeholders - roles, rights, responsibilities

5.4 Conflicting stakeholder objectives

Shareholders' objectives often conflict. It is often impossible for a business to satisfy all stakeholders all of the time. Two examples are given in Table 5.2.

All important business decisions must involve some stakeholders gaining and some losing and therefore a compromise might be necessary. Business managers will have to prioritise – which stakeholder groups are more important in this decision – and which ones might have to accept a negative impact? Can the business do anything to reduce the size of this negative impact?

For example:

- Pay substantial redundancy payments to workers who are losing their jobs.
- Support local community groups if some residents have to move for a new coal mine.
- Plant many trees to support an environmental group to counteract the carbon emissions of a new factory.

TIP

If you are asked to discuss a business decision it is often useful to consider the stakeholder groups likely to benefit and those likely to lose from it.

Decision	Stakeholders that benefit	Stakeholders that lose
Supermarket – expand the business operation by building a new warehouse.	<p>Workers – more jobs.</p> <p>Customers – more reliable deliveries and wider choice of stock.</p> <p>Government – increased economic activity and tax revenues.</p> <p>Suppliers – likely to be more orders.</p>	<p>Local community – additional transport of goods, for example, more trucks on roads.</p> <p>Environmental groups – building of warehouse uses 'greenfield' site and extra truck movements create more pollution.</p>
Café chain – purchase more coffee supplies from 'fair trade' producers, paying above market prices.	<p>Suppliers – offered 'fair trade' prices above the market price.</p> <p>Local community (of the suppliers) – higher local incomes will increase spending.</p> <p>Customers – those who want to buy 'ethical' products.</p>	<p>Customers – those who want lowest possible prices – they might rise to pay for the higher cost of 'ethical' supplies.</p> <p>Non – fair trade suppliers and their workers – fewer orders may lead to businesses failing and job losses.</p>

Table 5.2 Two business decisions and possible stakeholder impact

5.5 Changing business objectives and impact on stakeholders

Stakeholders can be affected by changes in business objectives. Here are two examples:

- 1 Economic recession forces a business to change objective from growth to survival – workers may lose jobs or have pay reduced.
- 2 Private limited manufacturing company converts to a public limited company and the business changes the objective from retaining control to rapid growth – more employment opportunities for workers; higher government tax revenue **but** pressure groups might be worried by environmental impact of increased industrial output.

Progress check B

- 1 Explain **two** responsibilities that a business has to its employees.
- 2 Explain **two** responsibilities that employees have to their employer.
- 3 Research a major decision recently taken by a business in your country. Explain how this decision might lead to conflicts between the business's stakeholders.
- 4 Assume that a privately financed school changes its structure and objectives from those of a social enterprise to a privately limited company owned by profit seeking shareholders. Explain how any **two** stakeholder groups are likely to be affected by these changes.

Exam-style question

Paper 1 (short answer question)

- 1 Explain briefly the rights of two of a supermarket's stakeholders. [3]

Student's answer

A supermarket will have many stakeholders, e.g. workers and local communities in which the shops operate. These are just two of the groups interested in the decisions and activities of a supermarket.

Workers have legal rights and these would include a contract of employment and working conditions that meet health and safety standards.

Local communities have the right to be asked if the supermarket is planning a large expansion of its shop. Members of the community might be worried about the extra traffic and deliveries by large truck. The community, e.g. local government, might have some control over planning rules.

Authors' comments

This answer is just the right length. It is important not to write too much for the short answer questions as a detailed essay question also needs to be answered on Paper 1.

The answer is clear, concise and accurate – an excellent answer.

Additional exam-style questions

Paper 1 (essay)

- 1
 - a Analyse why many businesses attempt to satisfy the objectives of stakeholder groups other than shareholders. [8]
 - b Discuss whether it is possible for a steel making business to satisfy the objectives of all of its stakeholders. [12]

Paper 2 (part question)

NMR Mining Group

'The opening of the new open-cast copper mine in this country will benefit all stakeholder groups.'

This was a recent headline in a company's internal newspaper. The NMR Mining Group is suggesting that its investment in Country A, a developing country, would be for the good of everyone.

The company plan was to use a large area for open-cast copper mining. Few people live in this area. A new road would be built from the capital city to transport the copper. The world price of copper is very high. It is needed by electronics industries in industrialised countries.

- 2 a Explain how any **two** stakeholder groups might be adversely affected by this decision. [4]
- b Evaluate the extent to which business decisions such as this lead to a conflict of stakeholder objectives. [11]

Business structure

Learning summary

After you have studied this chapter you should be able to:

- understand the main differences between local, national and multinational businesses
- understand the growing importance of multinational trading links and their impact on business activity
- discuss the benefits and disadvantages that a multinational might bring to a country and the relationship between MNCs and the state
- assess the advantages and disadvantages of privatisation in a given situation.

6.1 Local, national and multinational businesses

Local businesses have operations in just one location or region.

National businesses have operations in several locations or regions of a country but do not operate in other countries.

Multinational businesses operate in more than one country and these are termed 'multinationals'.

6.2 Multinational trading links

Trading links between nations are increasing rapidly and this is a major feature of **globalisation**. The main reasons for this growth are:

- Cheaper transport – especially when huge container ships are used.
- Fewer trade restrictions – free trade agreements have reduced the number of tariffs and quotas and other restrictions on trade in goods and services
- Internet – has increased the quantity of information about goods and services available in other countries.

The main impacts of growing multinational trading links are:

- More opportunities for businesses to sell in other countries – but it also creates more competition in local and national markets.
- Greater flows of capital around the world which is often controlled by multinational companies – but these

- flows can be quickly reversed causing instability and profits from capital investment are usually sent abroad.
- More choice for domestic consumers and prices are often lower as a result of importing goods and services.

TERM

Globalisation: the increasing freedom of movement of goods, capital and people around the world.

Progress check A

- 1 State one example from your own country of each of: local business; national business; multinational business.
- 2 List **three** goods that your country imports and **three** goods that your country exports.
- 3 Give examples from your own experience of how globalisation and multinational trade have increased consumer choice.

6.3 Multinational businesses

The recent growth of **multinational companies** can be explained by:

- Increased free trade and reduction in barriers makes it easier for businesses to start up operations in other countries (globalisation)

- Potential cost savings made by operating in a low-cost country
- Foreign operations might be closer to important markets – goods can be exported more easily
- Access to local resources that might not be available in 'home' country.

TERM

Multinational company (or corporation): businesses with headquarters in one country but with operating branches or factories in other countries. Commonly known as MNCs.

TIP

Be prepared to examine the impact of the growth of multinational corporations on your country's economy.

The impact of multinationals

Positive impact

Local jobs created

National output increases

May increase exports
May increase tax revenues

Skills of local workers increased

Negative impact

High income jobs go to foreign workers

Profits back to 'home country' so local profit tax avoided

Local competition squeezed out
Large-scale production could damage environment

Less cultural diversity



Figure 6.1 Advantages and disadvantages of multinational corporations to the countries they operate in

The relationship between multinationals and the states they operate in can be a close one – with the company helping governments meet their economic objectives and, commonly, governments providing financial incentives to the company to invest in their country. The issues to be considered when considering the impact of MNCs include:

6.4 Privatisation

Privatisation has been used by many governments in recent years. The reasons for this include:

- Raises finance for government
- Businesses can now operate without political control/interference
- Private owners will expect profits from their investment so the business will have to be operated efficiently
- Without government financial support the business will be subject to market forces – to be successful it will have to produce what customers are prepared to pay for
- It could lead to increased competition as other businesses enter the industry, forcing existing businesses to increase efficiency and possibly reducing prices for consumers.

TERM

Privatisation: selling state owned organisations to investors in the private sector.

Some economists and politicians are opposed to privatisation claiming that:

- some important public services may now be cut back if they are not profitable
- job losses are inevitable when the private owners attempt to improve efficiency to increase profits
- some industries are too important to be operated by private investors
- if a state controlled monopoly is replaced by a private owned monopoly then customers may be exploited with higher prices.

Progress check B

- 1 What factors are important in deciding whether the water supply industry in your country should operate in the public sector or the private sector?
- 2 Name **four** multinational businesses operating in your country.
- 3 Suggest reasons why each of these multinationals is operating in your country.
- 4 Suggest **three** benefits to your country from the operation of these multinationals.
- 5 Suggest **three** possible limitations to your country from the operation of these multinationals.

Exam-style question

Paper 3 (using an abbreviated case study)

National Minerals Ltd. (NML)

'I do not see how we are going to compete with ST Incorporated,' said Joe Chavez the managing director of NML at a meeting with government officials. This company extracts minerals from three quarries in Country X, a low income Country in South America. NML was set up three years ago when the government privatised all of the state owned mining businesses. 'ST is one of the largest multinational mineral producing and exporting companies in the world. It operates in 35 countries. ST Inc's decision to double the size of its operations in Country X by opening a huge new quarry could force us out of business. We will have to cut costs and become even more efficient – but even this might not be enough to survive.'

The government officials understood Joe's point but suggested that: 'Perhaps your business could aim to provide specialist knowledge and materials to ST Inc rather than try to compete with them head-on. ST's new quarry will provide jobs in a depressed region of the country and it will pay tax on its profits. ST has claimed that 50 per cent of the quarry's output will be sold abroad. The government is confident that the newly privatised mining businesses will be able to compete with new foreign rivals.'

- 1 Analyse **two** possible benefits to the economy of Country X from ST's increased operations there. [10]

	Before privatisation	After privatisation
Total profit made by mine industry	\$25 m	\$65 m
Numbers employed	35 000	23 000
Number of mines operating	23	16
Capital invested in new mines per year	\$5 m	\$21 m
Output per mine worker per year (2012 = 100)	102	125
Number of mining accidents per year	6	32

Table 6.1 Country X mining industry – before and after privatisation

Student's answer

ST is a multinational organisation as it operates in more than one country. Operating mines in Country X can lead to benefits for the country and its government.

One advantage will be in the creation of new jobs which will pay workers an income. As Country X is a low income country many of its population might either be unemployed or be in low income employment. The new jobs created by ST's expansion should increase the incomes of the workers employed. This will benefit Country X's economy and