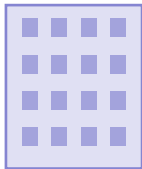


Business and its Environment

A-Level Business ■ Topic 1

A-Level Business



What we will cover

- 1 Purpose & adding value
- 2 Enterprise & the business plan
- 3 Sectors & legal structures
- 4 Size & growth
- 5 Objectives & stakeholders
- 6 Recap





Why businesses exist

A business combines the four **factors of production** to satisfy a need or want and, usually, to make a profit.

land

labour

capital

enterprise

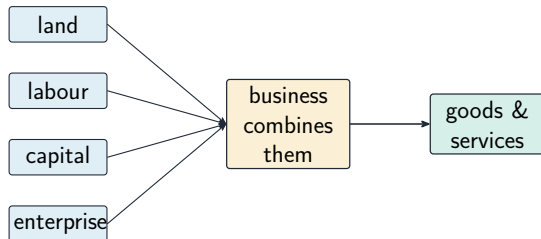
The market a business operates in



People have **needs** – food, shelter, what you must have – and **wants** , what you would like. A business exists to satisfy them, and usually to make a profit doing it.

The four factors, drawn

factors of production



Land is the natural things – soil, water, minerals; **labour** is the work people do; **capital** is the machines, tools, buildings and money used to produce; **enterprise** is the person who brings the other three together and carries the risk.

Adding value

Added value = selling price – cost of bought-in materials. Ways to raise it: better design, branding, convenience, quality, unique features.

Added value is not the same as profit – profit also subtracts wages, rent and other costs.



Entrepreneurs and enterprise

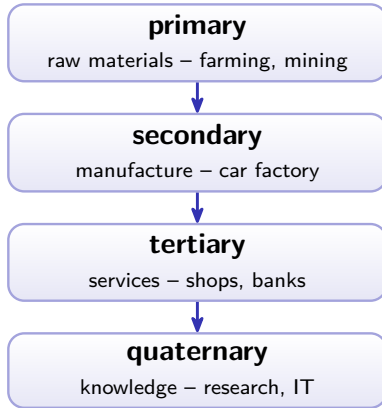
An **entrepreneur** takes the risk to start a business; an **intrapreneur** does so inside a firm. Traits: **innovative**, risk-taking, determined, self-confident.

Enterprise helps a country: more jobs, output (**GDP**), competition and **economic growth**.

A **business plan** helps win finance & set goals.



Sectors of business activity



- **primary** – raw materials
- **secondary** – manufacturing
- **tertiary** – services
- **quaternary** – knowledge

Private (profit) vs **public sector** (service).

The sectors, and the two halves of the economy

Primary sector

Takes from the earth: farming, fishing, mining, forestry.

Secondary sector

The **secondary sector** makes – manufactures – **goods** : a car factory, a baker.

Tertiary sector

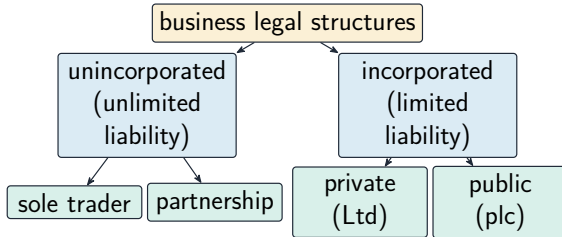
The **tertiary sector** provides **services** : shops, banks, transport.

Private and public

The **private sector** is owned by private people; the **public sector** by the state. A **social enterprise** trades like a business but aims at social or **environmental** good – cutting **pollution** , say – and reinvests most of its profit.

As a country develops the jobs move primary → secondary → tertiary. The sector mix is a development statistic in its own right.

Legal structures and liability



Sole trader , partnership , Ltd , plc , franchise .

Limited liability : owners lose only what they invest. Unincorporated = **unlimited**.

The legal forms, and how each is owned

sole trader

one owner, **unlimited liability**, keeps all the profit

partnership

two or more partners sharing work and profit, usually under a **deed of partnership**

private limited (Ltd)

shareholders, **limited liability**, shares not sold to the public

public limited (plc)

shares traded openly – large capital, and the risk of losing control

franchise

one firm uses another's brand and model: the **franchisor** owns the brand, the **franchisee** pays to use it

social enterprise

trades commercially but pursues a social objective with its surplus

Liability is the dividing line, and it decides how much capital the firm can raise – which is why the two questions are always asked together.

The legal forms, and who carries the debt

Sole trader and partnership

Unlimited **liability** : the owner must pay the business's **debts** from personal money if it cannot.

Private limited company

A **private limited company** (Ltd) sells **shares** to a small group – family, friends – and cannot advertise them.

Public limited company

A **public limited company** (plc) sells shares to the public on the **stock exchange** : more finance, less control.

Separate legal identity

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.

Franchise

The **franchisor** owns the brand; the **franchisee** pays a fee and a **royalty** to run a branch.

Limited liability is what separate legal identity buys: the shareholder can lose the money invested, and no more.



The size of a business

No single measure – use more than one:

employees

revenue

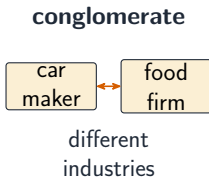
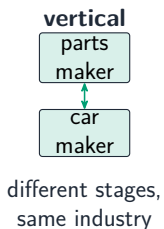
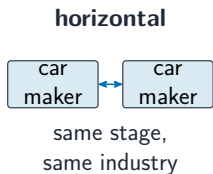
capital employed

market share

market capitalisation

Small businesses still matter – jobs, local service, quick to react, new ideas.

Business growth



Internal (organic) vs **external** (merger /takeover).

- **horizontal** – same stage
- **vertical** – different stage
- **conglomerate** – diversify

How firms grow, and the four kinds of integration

organic growth

selling more, opening more sites – slow but controlled

a merger

two firms agree to join together as one

a takeover

one firm buys control of another, agreed or not

horizontal

same stage of the same industry – market share and scale economies

forward / backward

vertical: toward the customer, or toward the supplier – control of the chain

conglomerate

unrelated industries – spreading risk

Growth by acquisition is fast and risky; organic growth is slow and safe. Which suits the firm depends on how quickly the market is moving.

How a firm grows, and in which direction

Internal growth

Internal growth (organic): the business grows by itself – selling more, opening branches, adding products. Slower, and it keeps control.

External growth

External growth : it joins with another firm. Fast, and it buys capability it does not have.

Horizontal integration

Horizontal integration : joining a firm at the *same* stage of the same industry – two car makers.

Vertical integration

Vertical integration : a different stage of the same industry. **Forward integration** is towards the customer (buying a shop), **backward integration** towards the supplier (buying a parts maker).

Conglomerate

Conglomerate integration : a different industry – risk spread by **diversification** .

Growth also costs: higher average costs, harder communication, different company **cultures** that clash, and a need for a lot of finance. A **joint venture** gets some of that without the merger.

Economies of scale

Economies of scale lower **average cost** as a firm grows (purchasing, technical, financial, managerial, marketing).

Grow too big $\Rightarrow$ **diseconomies** : poor communication, coordination, motivation.

Where economies of scale come from – and where they stop

purchasing

buying in **bulk** earns discounts

marketing

the advertising cost is spread over more units

technical

bigger machines run at a lower cost per unit

financial

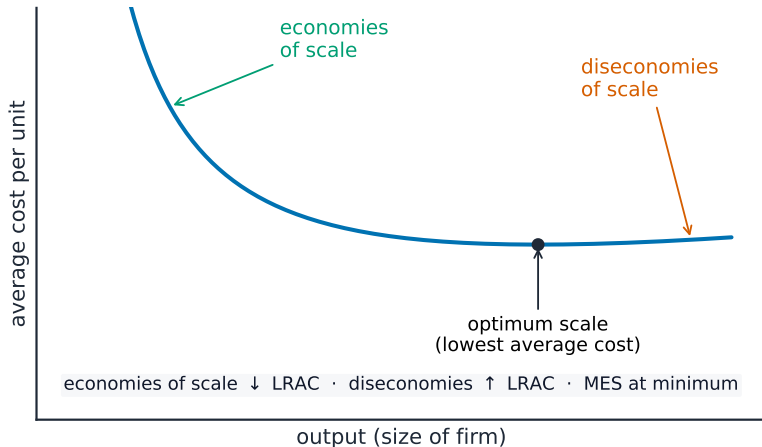
a large firm borrows more cheaply

diseconomies

past a point, **communication** slows, **coordination** of many departments gets hard, and workers lose **motivation**

The last row is what turns a 'state the economies' question into an evaluation.

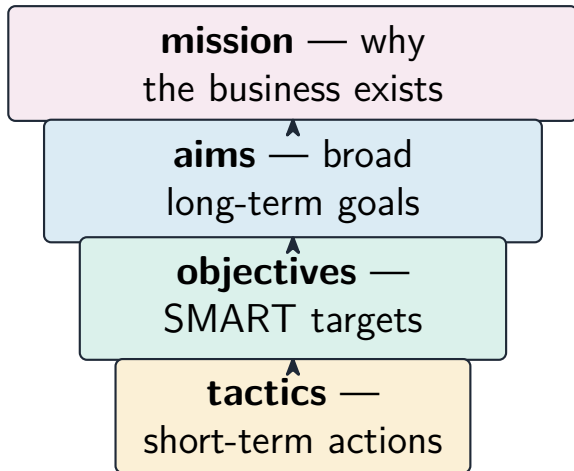
Economies of scale, in detail



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



Aims, objectives and mission



Mission → **aims** → **objectives**
→ tactics.

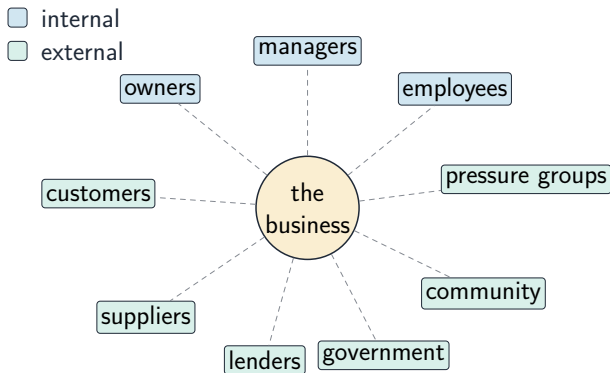
Good objectives are **SMART**:
Specific, Measurable, Achievable, Realistic, Time-bound.

Types: profit, growth, **survival**,
market share, **CSR**.

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.

Stakeholders



A **stakeholder** has an interest in the firm.

- **internal**: owners, managers, employees
- **external**: customers, suppliers, lenders, government, community

Their aims **conflict** ; manage by communication & **compromise** .

Internal and external stakeholders

Internal stakeholders

Internal stakeholders : owners, managers and employees – inside the business, and paid by it.

External stakeholders

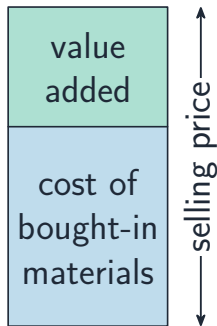
External stakeholders : customers, suppliers, lenders, government, local communities , and pressure groups .

Where they conflict

Higher wages against higher dividends; lower prices against supplier margins; expansion against the neighbourhood.

Name the stakeholder *and* the interest. “Stakeholders will be affected” scores nothing; “suppliers face longer payment terms” scores.

Adding value, continued



$$\begin{aligned} \text{value added} \\ &= \text{selling price} \\ &\quad - \text{materials cost} \end{aligned}$$

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

Entrepreneurs and intrapreneurs



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

What enterprise does for a country

new jobs

which lowers **unemployment**

export s

some firms grow and sell abroad, bringing money into the country

economic growth

more output, and a higher standard of living

tax revenue

which funds public services

competition and innovation

new firms force established ones to improve

the entrepreneur's own traits

determination, initiative, and **willing to take risks** – but in a careful way

Resources are **scarce** , so every business must choose how to use them well. Enterprise is the activity that makes that choice.

What a start-up needs, and what a country gains

Finance

Start-up costs, a **cash-flow forecast** and an expected profit – and **finance** from a bank or an **investor** .

A plan

A business plan sets out the idea, the market, the operations and the numbers; a **strategy** is the long-term plan for meeting the objectives.

Why a country gains

Business start-ups create jobs, serve local communities, give personal service, react quickly, bring new ideas, and supply parts and services to large firms.

Most start-ups fail on cash, not on the idea – which is why the cash-flow forecast is the document the bank reads first.

Types of business objective

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

The objectives a business can pursue

profit maximisation

the largest possible profit – the traditional assumption

survival

staying in business: vital for a new firm, and in hard times

growth

more sales, sites and staff – often at the expense of short-run profit

market share

a larger share of total sales, which brings scale economies later

social and ethical objectives

doing what is morally right – fair pay, fair sourcing

CSR

corporate social responsibility: acting in the interests of society and the environment, not only shareholders

A **mission statement** is one sentence saying why the business exists. Objectives are how that sentence is turned into something measurable.

Limited and unlimited liability

limited liability

companies
can lose safe

money put
into the firm

personal
house, car

the firm is a **separate legal identity**

unlimited liability

sole traders, most partnerships
can lose can lose

money put
into the firm

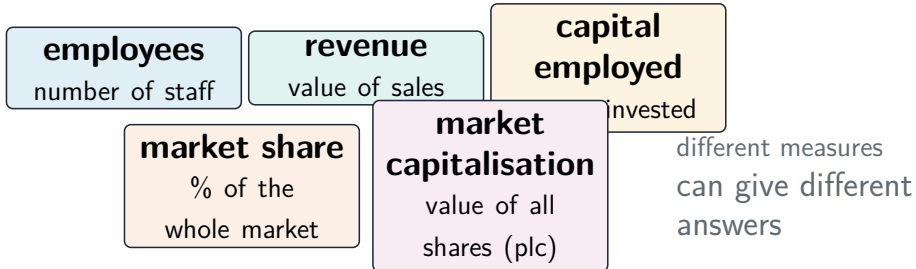
personal
house, car

the owner is **personally responsible** for all debts

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

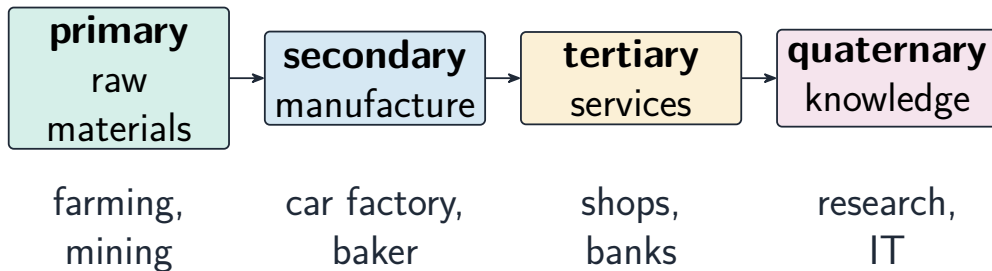
The size of a business, continued

how big is a business? - use more than one measure



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

Sectors of business activity, continued



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

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.



Worked example – added value

A maker buys wood for £80, pays £120 in labour, and sells the table for £350. Find the added value.

- Added value = selling price – cost of bought-in materials.
- $= 350 - 80 = \text{£}270$
- Labour is not deducted – it is one of the costs added value must cover.
- Raise it by branding, design or better service, not just by charging more.

The classic trap: added value is **not** profit. Profit deducts **every** cost; added value deducts only **bought-in materials**.

Topic 1 – key takeaways

1

Resources

four factors of production; add value

2

Structures

sole trader to plc; limited liability

3

Growth

integration; economies & diseconomies

4

Objectives

SMART; stakeholders' aims conflict

Check yourself

- 1 Name the four factors of production.
- 2 Which structure has unlimited liability?
- 3 What does the M in SMART stand for?
- 4 Give one internal and one external stakeholder.



Answers 1. land, labour, capital, enterprise 2. sole trader / partnership 3. Measurable 4. e.g. employee; customer