

Understanding Business Activity

IGCSE Business Studies ■ Topic 1

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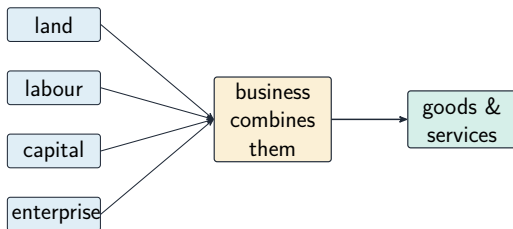
What we will cover

- 1 Purpose & factors of production
- 2 Scarcity & added value
- 3 The three sectors
- 4 Entrepreneurs & ownership
- 5 Business growth
- 6 Economies of scale & stakeholders



Purpose and factors of production

factors of production



- Goods are physical things you can touch – bread, phones, cars.
- Services are useful actions done for you – a haircut, a bus ride, a doctor's visit.

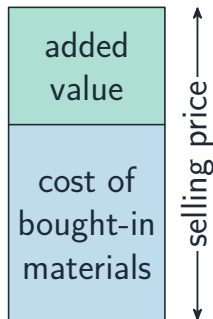
The economic problem

But resources are **scarce** – there are not enough of them for everything.

Because resources are scarce, you must always choose.

Scarcity and added value

- raising the price, often through a strong **brand** or better design,
- lowering the cost of materials, for example by finding cheaper suppliers,
- improving the product so customers will pay more.



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

Worked example – added value, and the distractor

A furniture maker buys wood and fabric for a chair for £40 and sells the chair for £110. Factory rent is £6,000 a month. Find the added value.

- added value = selling price – cost of bought-in materials
- = £110 – £40 = £70
- the rent is a deliberate distractor

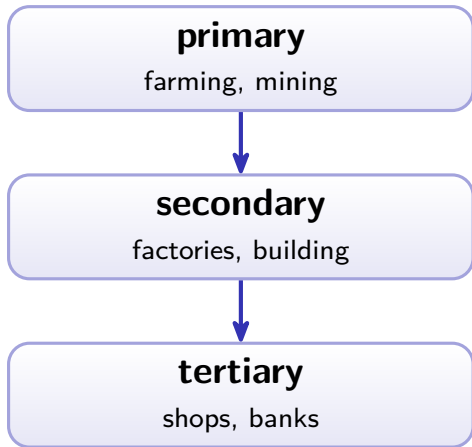
Added value counts **only** the bought-in materials. Rent, wages and other running costs stay *out* of it – they come off later, when you work out profit.

Why businesses succeed or fail

A business is more likely to succeed when it has:

- good **management** – skilled leaders who plan well,
- enough **finance** – money to pay bills while it grows,
- a product customers want, and an edge over the **competition** (the other businesses selling similar things).

The three sectors



- **primary** – takes natural resources
- **secondary** – makes goods
- **tertiary** – provides services



Entrepreneurs and ownership

the entrepreneur

takes **risk** , is **innovative** ; writes a **business plan** to raise finance

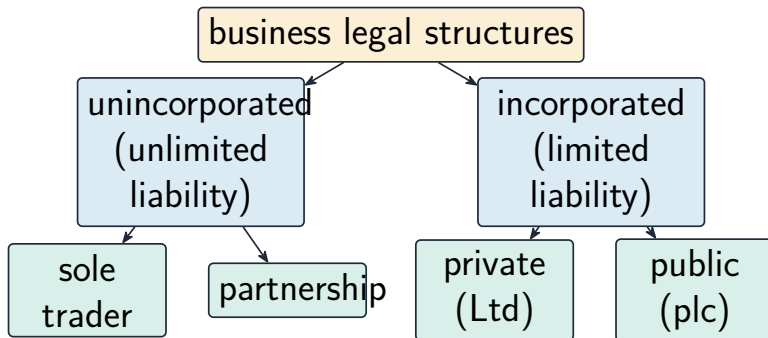
two sectors

private aims for **profit** ;
public provides services

Business organisation

Owners split by **liability** :

- **sole trader & partnership** – unlimited liability
- **limited company** – limited liability



Government support for start-ups

A **start-up** is a brand-new business.

- **grants** – money given that does not have to be paid back,
- low-interest **loans** – money lent on easy terms,
- training and advice for new owners,
- lower taxes in the first years.

Franchises, and the public sector

franchise

the **franchisee** pays to use the name, products and methods of an existing successful business (the **franchisor**)

why take one

a known brand and a proven method – so the risk of failure is far lower

the cost

a fee plus a share of the revenue, and **little freedom** to change anything

public corporation

owned and run by the government – a national rail or postal service

its aims

a **service to everyone** rather than the largest profit – which is why it may run routes no private firm would

A public corporation is judged on different objectives from a private firm. Comparing them on profit alone misses the point of the question.

Staying small or growing

Some businesses stay small on purpose: the owner wants to keep control, the market is small, or the product is specialised.

- **Internal growth** (also called organic growth): the business grows by itself, by selling more, opening new branches, or adding new products. It is slower but lower-risk.
- **External growth** : the business joins with another business. This is faster.

Four ways to measure a business's size

number of employees

simple to count – but a factory full of machines may employ very few people

value of output

how much it produces – but output is not the same as what it sells

capital employed

the money invested in it – but a capital-heavy firm may be small in every other sense

value of sales

turnover – but high sales can come with low profit

the point

every measure has a limitation, so a question asking “how big is this business?” wants at least two

Use more than one measure and say why they disagree. That comparison is the answer; a single number is not.

Objectives of a social enterprise

A social enterprise aims for three kinds of objective together:

- economic – earn enough money to survive and grow,
- social – help people, for example by giving jobs to those who find work hard to get,
- environmental – protect the planet, for example by cutting waste.

What businesses actually aim at

profit

earning more than it spends – the **main** aim of most private firms

survival

the first aim of a new business, and of any business in a downturn

growth

more sales, more sites, more staff – often at the cost of short-term profit

market share

the share of total sales in a market that one business holds

customer service

keeping customers happy so they **come back**

social objectives

helping society or the **environment** – the defining aim of a social enterprise

Objectives **change over time**. A firm that aimed at survival in year one may aim at market share in year five, and the exam asks you to say why.

Business growth

internal growth

grow by itself – new branches
& products; slower, safer

external growth

merger or **takeover** : hori-
zontal, vertical or conglomerate

Three kinds of integration

horizontal

two firms at the **same stage** of the same business – two car makers join

vertical

two firms at **different stages** of the same business – a car maker buys a tyre maker

conglomerate

two firms in **completely different** businesses – a car maker buys a food company

why horizontal

more market share, and economies of scale in the same activity

why vertical

control of supply or of the route to the customer

why conglomerate

spreading risk – if one market falls, the other may not

Name the type first, then give its *reason*. “Vertical, so it controls its own supply of tyres” earns both marks in one line.

Integration, and the sectors it crosses

Horizontal integration

Horizontal integration : joining a firm at the same stage of the same industry.

Vertical integration

Vertical integration : joining a supplier or a customer – forward towards the market, backward towards the input.

Conglomerate integration

Conglomerate integration : a different industry altogether, to spread risk.

Joint venture

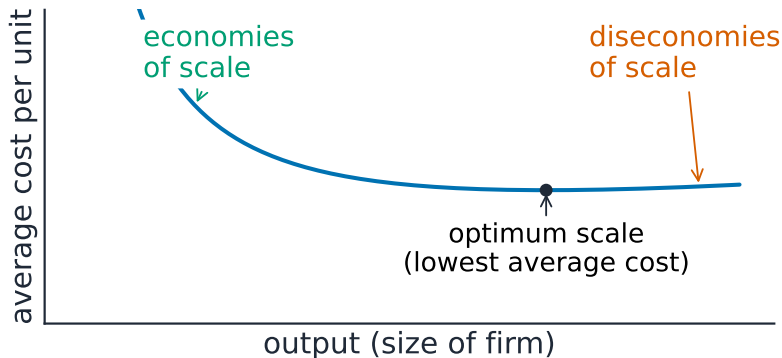
A **joint venture** shares one project's costs and risks without a merger – often how a firm enters a foreign market.

Growth means new **debts** as well as new revenue. Say how it is financed before judging whether it was wise.

Economies of scale

As a business grows, the cost **per unit** falls – **economies of scale** . Grow too big & it can rise again (**diseconomies of scale**).

Economies of scale, in detail



LRAC: economies → min AC → diseconomies

As a business grows, the cost **per unit** falls – **economies of scale** .

The five economies of scale

purchasing

buying in bulk lowers the cost of each unit

financial

large firms can **borrow money more cheaply**, because lenders see less risk

managerial

the firm can afford **expert managers** for each function

technical

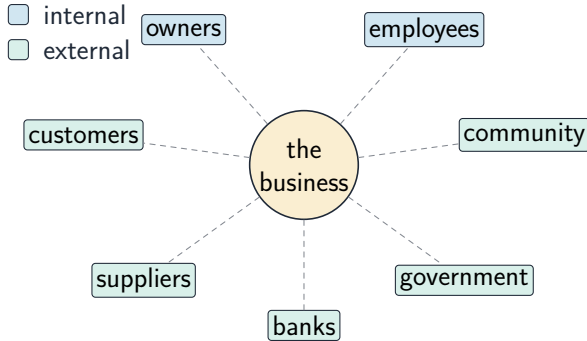
it can use **large, efficient machines** that a small firm could never fill

marketing

the cost of **advertising** is **spread over more goods**, so each unit carries less of it

All five lower the **average cost per unit**. Diseconomies – poor communication, low morale, slow decisions – push it back up when the firm grows too large.

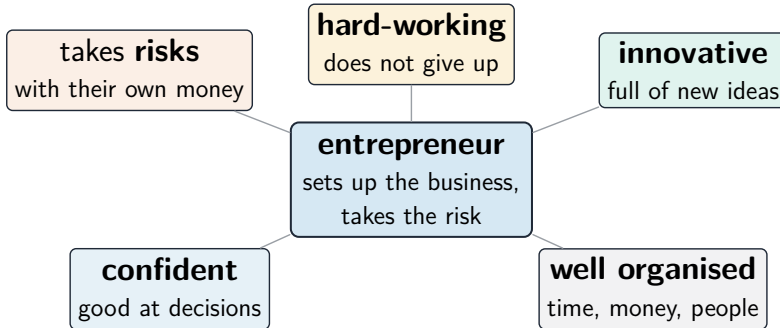
Stakeholders



A **stakeholder** is anyone affected by the business.

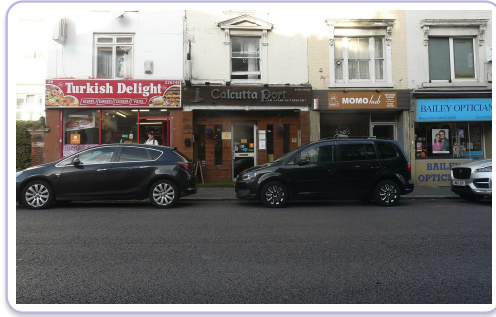
- internal: owners, workers, managers
- external: customers, suppliers, government, community

The entrepreneur



What successful entrepreneurs are usually like

What business activity is for



Shops competing on a high street: businesses make goods and services to meet people's wants.

What business activity is for, continued



Businesses make goods and services to meet people's needs and wants

Types of business organisation



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

The four main types of business organisation

sole trader

one owner, easy to set up, keeps all profit – but **unlimited liability** and hard to raise money

partnership

easy to set up and more capital; but partners can disagree, and **one partner's mistake affects everyone**

private limited company

“Ltd”: owned by **shareholders**, shares **cannot** be sold to the public. Limited liability, control stays in a small group – but accounts must be filed with the government

public limited company

“plc”: shares sold on the stock exchange, so it **can raise very large amounts of capital** – but it is expensive and complex to set up, and control can be lost

the payment

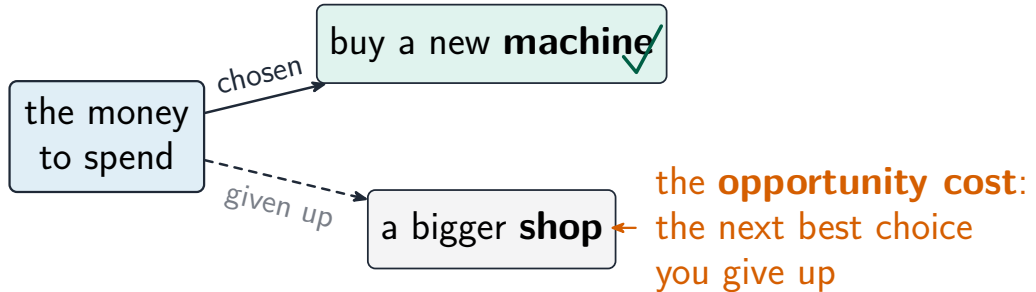
shareholders may receive a share of the profit, called a **dividend**

Limited liability is the dividing line: an owner of a limited company risks only what they invested, never their house.

Incorporated and unincorporated

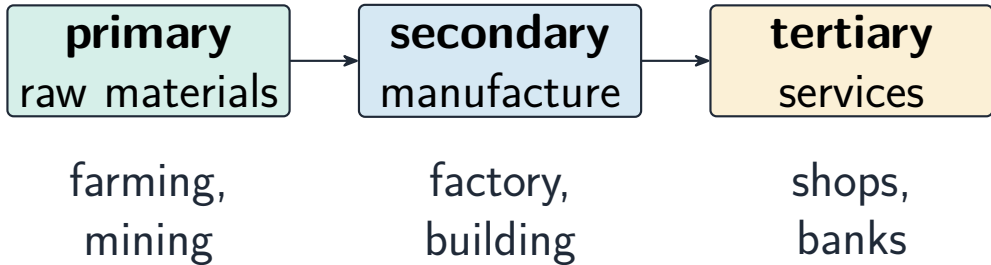
- An **incorporated** business has a separate legal identity from its owners. The business itself can own things and be taken to court. Its owners get limited liability.
- An **unincorporated** business is not separate from its owner in law. Sole traders and partnerships are unincorporated.

Opportunity cost



The opportunity cost is the next best choice you give up

The three sectors, continued



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

The sectors, and how they shift

Primary

Farming, fishing, mining – extraction, and the largest employer in a **developing economy** .

Secondary

The **secondary sector** : **manufacturing** and construction – turning materials into goods.

Tertiary

Services: retail, transport, finance, health – and the largest sector in a **developed economy** .

De-industrialisation

De-industrialisation is the fall in the secondary sector's share as an economy develops – jobs move to services, and often abroad.

The **private sector** is owned by individuals, the public sector by the state, and both operate in all three sectors.

Exam tips

- **Added value** = selling price — cost of bought-in materials. A business raises it with a strong brand, better design, or cheaper materials.
- Know the three sectors: **primary** (extracts raw materials), **secondary** (makes goods), **tertiary** (services). As a country develops, employment shifts from primary towards tertiary.
- **Unlimited liability** (sole traders, partnerships) puts the owner's personal things at risk; **limited liability** (Ltd, plc) limits any loss to the money invested.
- A **stakeholder** is anyone affected by the business, and their objectives often **conflict** — owners want profit, workers want higher pay, the community wants less pollution.
- **Economies of scale** cut the cost per unit as a firm grows; growing *too* big brings diseconomies of scale (cost per unit rises).



Worked example – the three sectors

A farm sells wheat to a mill, which sells flour to a bakery, which sells bread in its own shop. Name each sector.

- **Primary:** taking natural resources from the earth ⇒ **the farm.**
- **Secondary:** making or processing goods ⇒ **the mill and the bakery.**
- **Tertiary:** providing a service ⇒ **the shop that sells the bread.**
- Each stage **adds value** to what it bought from the stage before.

As a country develops, employment shifts **primary** → **secondary** → **tertiary**.
One firm can sit in several sectors at once – a bakery with a shop does.

Topic 1 – key takeaways

1

Factors

land, labour, capital, enterprise

2

Added value

selling price minus bought-in materials

3

Sectors

primary, secondary, tertiary

4

Growth

internal vs external
(merger/takeover)

Check yourself

- 1 Name the four factors of production.
- 2 What is opportunity cost?
- 3 Which sector provides services?
- 4 What does a limited company give its owners?



Answers 1. land, labour, capital, enterprise 2. the next best choice given up 3. the tertiary sector 4. limited liability