Business and its environment (AS)

Enterprise and entrepreneurs, business structures and legal forms, the size and growth of businesses, business objectives, and the stakeholders in a business and how their interests conflict.

A **business** uses **resources** (inputs) to produce **goods and services** (outputs) that customers want, aiming to meet its objectives. This chapter looks at who starts businesses, how they are organised and sized, what they are trying to achieve and who is affected by them.

1.1 Enterprise

Enterprise and entrepreneurs

Enterprise is the skill of identifying a business opportunity and taking the risk of starting a business to exploit it. An **entrepreneur** is the person who does this: they **organise the other factors of production** (land, labour, capital) and **take the risk** in return for the possibility of **profit**.

Characteristics of successful entrepreneurs: creativity and innovation, **risk-taking**, **determination and self-belief**, **leadership**, **hard work** and the ability to **spot opportunities**.

Reasons why people start businesses	Reasons why businesses fail
to be their **own boss** and have independence	**poor cash flow** and running out of cash
to **make a profit** and build wealth	**lack of market research**: no real demand
to turn an **idea or hobby** into a living	**poor management** and lack of experience
to **meet a need** they have seen	**competition** from stronger firms
redundancy or lack of other jobs	**over-expansion** or poor control of costs

Intrapreneurs

An **intrapreneur** is an employee who acts like an entrepreneur **inside an existing business**: they spot opportunities, develop new products or processes and take initiative, using the **firm's resources** and bearing less personal risk. **Intrapreneurship** keeps a business **innovative and competitive** as it grows.

Qualities: creativity, **initiative**, **willingness to take calculated risks**, **drive and persistence**, **good communication** and the ability to **win support** from colleagues.

Businesses **develop employees to encourage intrapreneurship** by giving **freedom and time** to try ideas, **rewarding** successful ideas, **training**, **empowering** staff and building a culture where **failure is**

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tolerated as learning.

Barriers, risk and enterprise in the economy

- **Barriers to entrepreneurship: lack of finance**, **lack of experience**, **fear of failure**, **regulation and red tape**, **strong existing competitors** and a lack of **support or infrastructure**.
- **Risk and uncertainty: risk** can be estimated (the chance of failure is known roughly); **uncertainty** cannot be measured because the future is unpredictable. Entrepreneurs accept both for the chance of reward.
- **Enterprise and a country's development:** new businesses create **jobs, output, tax revenue and innovation**, and can raise **exports** and **living standards**.
- **Scope of business: local** businesses serve a small area, **national** ones a whole country, **international** ones trade abroad and **multinationals** have operations in several countries.

Business plans and start-up problems

A **business plan** sets out the business's **aims, the market, the product, the marketing, the finance needed and forecast cash flow and profit**. It is used to **persuade lenders and investors** and to **focus the owner's own thinking**.

Typical **start-up problems**: **raising enough finance**, **lack of an established customer base**, finding **suitable premises**, building **reputation**, **cash-flow** gaps while waiting for customers to pay, and **legal requirements**.

Business and the economy

- **Public sector** businesses are owned by the **government**; **private sector** businesses are owned by **individuals or groups**.
- **Added value** is the **difference between the selling price and the cost of the inputs** bought in. Raising it raises profit. Ways: improve **branding**, better **quality**, **lower input costs**, **innovation**, better **service**.
- **Sectors: primary** (extracting raw materials), **secondary** (manufacturing and construction), **tertiary** (services) and **quaternary** (knowledge-based activity such as **research and development, IT, consultancy and education**). Economies usually shift from primary towards tertiary and quaternary as they develop, because rising incomes raise demand for services and technology changes how work is done.

> **Added value = selling price − cost of bought-in materials and services. A cake sells for $4 and the ingredients cost $1.20, so added value is $2.80.**

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Social enterprise

A **social enterprise** is a business set up to achieve **social or environmental aims** as well as **financial viability**. Profits are mainly **reinvested** in the cause. Examples: a fair-trade café that trains the long-term unemployed.

Purpose, environment and plans

The **purpose of business activity** is to **meet people's needs and wants** by producing goods and services, and to **create value** (profit, jobs, tax). The **business environment is dynamic**: **technology, competition, customer tastes, laws and the economy** keep changing, so firms must **adapt** to survive. **Why businesses succeed: good planning and research**, **a clear market**, **good management**, **adequate finance** and the **ability to change**.

The **key elements of a business plan** are an **executive summary**, the **aims and objectives**, the **product**, **market research and the target market**, the **marketing plan**, **operations and location**, the **management team**, **forecast finance** (cash flow, break-even, profit) and the **risks**. **Benefits:** it **focuses thinking**, **persuades lenders**, and gives **targets**. **Limitations:** it **takes time**, rests on **forecasts that may be wrong** and can become **out of date**.

1.2 Business structure

Legal forms of business

Form	Ownership and liability	Main points
Sole trader	one owner; **unlimited liability** (personal assets at risk)	easy to set up, full control and profit; limited finance, owner bears all risk, **no continuity**
Partnership	two or more owners; usually **unlimited liability**	more finance, **shared skills and workload**; **disagreements**, shared liability for each other's decisions, profits shared
Private limited company (Ltd)	shareholders, **limited liability**, shares **cannot be sold to the public**	owners' losses limited to what they invested, more finance, **separate legal identity**; more **regulation and disclosure**, shares hard to sell
Public limited company (plc)	shares **can be sold on a stock exchange**, limited liability	**large amounts of finance**, easy to sell shares; **loss of control** (takeover risk), strict **disclosure**, pressure for short-term profit, costly to set up

Limited liability means shareholders can lose **only the money they invested**, not personal assets. A **separate legal identity** means the company can own property, sue and be sued and continues after an owner leaves.

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Other forms of organisation

- **Franchise:** a **franchisee** pays the **franchisor** a fee and a share of revenue to use its **brand, products and support**. Lower risk for the franchisee, but **royalties** and limited freedom.
- **Joint venture:** two businesses **share costs, risks and expertise** in a project and agree the split of profits.
- **Co-operatives** and **public corporations** (government-owned) also exist.

Public and private sector, and privatisation

Privatisation is the **sale of state-owned assets to the private sector**. Arguments for: more **efficiency**, competition and **proceeds for the government**. Against: loss of **strategic control**, possible **monopoly power** and the neglect of unprofitable services.

Economic sectors and ownership

The **primary** sector extracts raw materials, the **secondary** manufactures and builds, the **tertiary** provides services and the **quaternary** is knowledge-based (R&D, IT, consultancy). The **public sector** is owned and run by the **state**; the **private sector** is owned by **individuals and companies**. As economies develop, **employment and output shift** away from primary and secondary towards **tertiary and quaternary** activity, because of **rising incomes**, **automation**, **imports of cheap manufactures** and **new technology**. **Consequences: job losses and regional decline** in older industries, **new skills** needed, and a bigger **services** sector.

Appropriate ownership depends on the **finance needed**, the **risk** the owners accept, the desire for **control**, and the **size and plans** of the business: a **sole trader** suits a small, low-risk start-up; a **limited company** suits growth and a need to limit liability. A business **may change form**: becoming a **limited company** brings **limited liability and more finance** but **more regulation, disclosure and loss of control**; **floating as a plc** brings **large funds** but **takeover risk** and pressure from shareholders; a **partnership** may become a company to **protect owners' assets**.

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1.3 Size of business

Measuring size

Measure	Notes
Number of employees	easy, but misleading if the firm is capital-intensive
Revenue (sales turnover)	easy to compare; high revenue does not mean high profit
Capital employed	the value of the finance used in the business
Market share	**a firm's sales ÷ total market sales × 100**

Market share (%) = firm's sales ÷ total market sales × 100. If a firm sells $30m in a $200m market, its share is 15%.

Growth

Internal (organic) growth comes from **within the business**: selling more, new products or new branches. It is **slower** but keeps **control** and is **less risky**.

External growth is through **merger or takeover**:

Type	Meaning	Example reason
Horizontal	same stage of production, same industry	more market share, **economies of scale**, less competition
Vertical backward	with a **supplier**	secure supplies, control quality and cost
Vertical forward	with a **distributor or retailer**	control the route to customers
Conglomerate	**unrelated** industry	**spread risk**

A **merger** is two firms agreeing to join; a **takeover** is one firm buying control of another.

Problems of rapid growth: cash-flow pressure, **loss of control and communication**, **diseconomies of scale**, culture clash after mergers, over-reliance on borrowing.

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Economies and diseconomies of scale

Economies of scale are **falls in average (unit) cost as output rises**. **Internal** economies include **purchasing** (bulk discounts), **technical** (larger, more efficient machinery), **financial** (cheaper borrowing), **managerial** (specialist managers) and **marketing** (spreading advertising costs). **Diseconomies** (rising unit cost at very large sizes) come from **poor communication**, **slow decisions** and **lower motivation** of workers.

Why small businesses survive

They can offer **personal service**, serve **niche or local markets**, are **flexible**, have **low overheads**, and may face little competition from large firms.

Family businesses and strategic alliances

A **family business** is owned and run by family members. **Strengths: commitment and trust**, **long-term thinking**, **flexibility** and a strong **reputation**. **Weaknesses: limited finance and skills**, **family conflict**, **succession problems** and reluctance to bring in outside managers.

Small businesses matter to the economy because they **create many jobs**, **bring innovation and competition**, serve **niche markets** and **supply larger firms**; in some industries (for example construction and restaurants) small firms **are the industry structure**.

Mergers, takeovers and alliances

A **friendly merger** is **agreed** by both boards; a **hostile takeover** is a bid made **against the wishes** of the target's management. **Impact on stakeholders: shareholders** may gain a **share price premium**; **employees** risk **redundancy and culture clash**; **customers** may face **less choice** or gain **better service**; **suppliers** may lose or gain contracts. A merger **may fail** because of **clashing cultures**, **poor integration**, **paying too much**, **debt**, **loss of key staff** and **diseconomies of scale**; it may succeed through **economies of scale**, **market share** and **complementary skills**.

A **joint venture** is a **new business set up jointly** by two firms; a **strategic alliance** is a **co-operation agreement** without forming a new company (for example sharing technology or distribution). Both give **access to markets, skills and finance** and **spread risk**, with **less cost and risk** than a takeover, but profits and **control are shared** and partners can **disagree**.

The **appropriate measure of size** depends on the purpose: **employees** for labour-intensive firms, **revenue** for market position, **capital employed** for capital-intensive firms and **market share** for competitiveness.

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1.4 Business objectives

Objectives are the **specific, measurable goals** a business works towards; they give **direction** and a basis for judging performance. Mission statements describe the overall purpose; objectives turn it into targets.

Objective	Explanation
Profit maximisation	the highest profit; reward for owners
Growth	a bigger market share and revenue; more power and security
Survival	essential for new or struggling firms
Cash flow	able to pay bills as they fall due
Market share	a bigger share of sales than rivals
Social and ethical objectives	environmental and community aims; **corporate social responsibility**

> **Objectives are set so they are SMART: Specific, Measurable, Achievable, Realistic and Time-bound.**

Objectives **differ** by type of firm and **change** over time: a start-up wants survival, a mature firm wants market share or profit, a social enterprise puts social aims first. **Conflict** appears between objectives, for example **profit maximisation** now versus **growth** or **ethical** sourcing.

Mission, aims, objectives, strategy and tactics

Level	Meaning
Mission statement	the **overall purpose** and values of the business
Aims	the **long-term, general** goals
Objectives	**specific, measurable** targets to achieve the aims
Strategy	the **long-term plan** for reaching the objectives
Tactics	the **short-term actions** that carry out the strategy

Decision-making follows **stages**: **set objectives**, **collect and analyse information**, **identify options**, **choose**, **implement** and **review** the results. Objectives **guide** every stage and give a standard for **judging** success; they are turned into **targets and budgets** for each department. They must be **communicated**

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clearly: understood objectives **motivate** and align the workforce, but unclear or unrealistic ones **demotivate**. Objectives **change over time** (survival first, then growth or profit).

Private sector objectives are mainly **profit, growth and market share**; **public sector** organisations focus on **service quality, value for money and meeting social needs**; **social enterprises** put **social and environmental aims** first. The **triple bottom line** judges a business on **economic (profit), social (people) and environmental (planet)** results, which is how **CSR** is measured. **Ethics** (what is right and wrong) can **limit** objectives, for example refusing to use **child labour** or to mislead customers even where it would raise profit.

1.5 Stakeholders in a business

A **stakeholder** is **any individual or group with an interest in a business and its activities**.

Stakeholder	Interest
Owners / shareholders	**profit and dividends**, rising share price
Managers	pay, **status**, success of the business, **job security**
Employees	**wages**, security, good conditions, promotion
Customers	**quality**, value for money, safety, choice
Suppliers	**prompt payment** and **regular orders**
Lenders (banks)	**repayment** with interest, low risk
Government	**taxes**, jobs, law-abiding behaviour
Local community	**jobs**, environmental impact, noise and traffic

Internal stakeholders (owners, managers, employees) work in the business; **external** stakeholders (customers, suppliers, lenders, government, community) are outside it.

Conflicts of interest

- **Shareholders** want high profit and dividends; **employees** want higher pay; both cannot always be satisfied.
- **Customers** want low prices; **suppliers** want high prices.
- **Local community** wants low pollution; **owners** want low-cost production.

Managers **balance** these through **negotiation** and **compromise**, and decide whose interests carry **more weight**, which depends on stakeholders' **power** and **interest**. Good stakeholder relations can improve **reputation**, loyalty and **long-term profitability**.

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Name one conflict between shareholders and employees, and one way a business might reduce it.

Shareholders want **higher dividends**, which means **keeping wages low**; employees want **higher pay**. A business might introduce **profit-sharing** so employees gain when profit rises.

Roles, rights, responsibilities and accountability

Each stakeholder has **roles, rights and responsibilities**: **shareholders** own the company, have the **right to vote and receive dividends** and the responsibility to appoint **directors**; **employees** have **rights** to fair pay and safe conditions and a responsibility to **work to a standard**; **managers** must run the business **in the owners' interest and within the law**; **customers** have rights to **safe, honestly described products**; **government** sets **laws and collects tax**.

A business is **accountable** to its stakeholders: it must **explain and justify its actions**, through **published accounts**, **annual reports**, **meetings with shareholders** and **responses to regulators and customers**. This builds **trust and reputation**.

The **influence** of a stakeholder depends on its **power** (for example shareholders voting, employees striking, large customers). **Business decisions affect stakeholders**, who may **react**: employees may **protest**, customers may **boycott**, and the community may **campaign**. **Stakeholders' aims affect decisions**: a business may avoid **redundancies** because of union pressure. **If objectives change** (for example from growth to cost-cutting), **employees and suppliers** may lose out while **shareholders** gain.

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