External influences on business activity

The business cycle, how government taxes, spending and interest rates affect businesses, environmental and ethical issues, globalisation, tariffs and quotas, multinational companies and the effect of exchange rate changes.

A business does not operate in isolation. **External influences**: the state of the economy, government decisions, environmental and ethical pressures and the global economy, create **opportunities and constraints**.

6.1 Economic issues

The business cycle

The **business cycle** is the pattern of **ups and downs in economic activity** over time.

Stage	What happens
Growth (expansion)	output, incomes and spending rise; unemployment falls
Boom	the **peak**: very high demand, low unemployment, but prices and wages may rise fast
Recession	output **falls**; spending drops and unemployment rises (usually two or more quarters of falling GDP)
Slump (depression)	the **lowest point**: very low demand, high unemployment, many business failures

Effects on businesses

Indicator	Effect on businesses
Employment level	high employment means **more spending** and higher sales but **labour is harder to recruit and wages rise**; high unemployment means weak demand but easy recruitment
Inflation (a general rise in prices)	**costs rise** (wages, materials), customers' **spending power falls**, it is harder to plan; **very low or negative inflation** can mean weak demand
GDP (total output of the economy)	**rising GDP** means higher incomes and demand; **falling GDP** (recession) cuts demand, especially for luxuries

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In a **boom** businesses expand and invest. In a **recession** they cut costs, lower prices, cut production, make workers redundant and **focus on essential products**.

Government control over the economy

Government objectives often include **economic growth (increasing GDP)**, **low unemployment**, **stable prices (low inflation)** and a healthy **balance of payments**.

Government action	Effect on businesses	How businesses may respond
Higher taxes (income tax, VAT, corporation tax)	customers have **less to spend**; **business profits fall** (corporation tax); VAT raises prices	cut costs, absorb the tax or raise prices, find cheaper suppliers
Lower taxes	more spending power and higher profits	expand and invest, hire
Higher government spending	more demand, especially for firms that **supply the government** (construction, defence, health)	increase output
Cuts in government spending	contracts and demand fall	find new customers, cut capacity
Higher interest rates	**borrowing costs rise** (loans, overdraft), customers **spend less** (loan costs, saving becomes attractive), **demand falls**; sectors that rely on credit (cars, housing) are hit hardest	reduce borrowing, delay expansion, cut costs
Lower interest rates	cheaper borrowing, more spending	expand, invest and borrow

> **A rise in interest rates raises the cost of borrowing and reduces consumer spending, which hurts businesses; a fall does the reverse.**

6.2 Environmental and ethical issues

The environment

Business activity can **harm the environment**: **pollution** (air, water, noise), **global warming** (greenhouse gas emissions), **waste**, use of **non-renewable resources**, **deforestation**.

Externalities are the **costs or benefits of a business's decisions that fall on people other than the business**:

- **External costs**: pollution from a factory, noise, traffic congestion, loss of green space.

Note Academy

- **External benefits**: jobs and income for the local community, better roads, training and skills.

Sustainable development means meeting **today's needs without harming the ability of future generations** to meet theirs. Businesses can contribute by using **renewable energy**, **recycling and cutting waste**, **sourcing sustainable materials** and reducing **emissions**.

Environmental concerns as opportunities and constraints

	Examples
Constraints	higher **costs** (clean technology, waste disposal), **laws and fines**, restrictions on production
Opportunities	**green products** that customers value, a **better brand image**, lower costs from **saving energy and materials**, new markets (renewable energy)

Why and how businesses respond to pressure: because of **consumer pressure** (people prefer green firms), **pressure groups** and **bad publicity**, **government rules**, and the chance of **lower costs and a better reputation**. They respond by cutting emissions, recycling, using sustainable packaging, publishing environmental reports.

Legal controls over the environment: **pollution controls**, limits on emissions, waste-disposal rules, and **fines** or closure for breaking them. They **raise costs** but protect the environment and create a level playing field.

Ethical issues

Ethics are principles about **what is right and wrong**. Businesses can face a **conflict between profit and ethics**: using **child labour**, paying very low wages, using **cheap, unsafe** materials, misleading advertising or **bribery**.

Responses: refuse to use child labour, pay a **fair price to suppliers** (fair trade), improve working conditions, be honest in advertising. **Benefits** of acting ethically: better **reputation**, loyal customers, motivated staff; **limitation**: **higher costs**, and competitors who do not act ethically may be cheaper.

6.3 Business and the international economy

Globalisation

Globalisation is the **growing connection of the world's economies**: more trade, movement of capital and people, and spread of ideas and brands.

Reasons for it: **faster transport and communication** (the internet), **lower trade barriers**, **multinational companies**, **cheaper travel**, and demand for goods from abroad.

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	Opportunities	Threats
For businesses	**bigger markets**, cheaper **raw materials and labour** abroad, spreading risk, **economies of scale**	**more competition** from foreign firms, **exchange rate** risk, cultural differences, risk of **bad publicity** over overseas working conditions

Import tariffs and quotas: a **tariff** is a **tax on imports**; a **quota** is a **limit on the quantity** of imports. Governments use them to **protect domestic businesses and jobs** from foreign competition, raise revenue (tariffs), protect new industries and respond to **dumping**. **Effect on business**: imported goods cost more or are scarcer, which helps local firms but **raises costs for firms that use imports** and may prompt retaliation.

Multinational companies (MNCs)

An **MNC** is a business that **operates in more than one country**. **Reasons for their growth**: access to **new markets**, **lower costs** (cheap labour, materials), avoiding **trade barriers** (producing inside a country that has tariffs), economies of scale, spreading risk.

Benefits to the business: bigger sales, lower costs, brand recognition, risk spread across countries. **Impact on stakeholders**: **shareholders** gain from higher profit; **employees** may gain jobs or lose them if work is moved abroad; **customers** may get better products; **local communities** may face pollution.

Benefits to the host country: **jobs**, **exports**, **investment**, **taxes**, **greater choice**, new **skills and technology**.

Drawbacks to the host country: **local businesses** may lose sales and close, **profits may be sent back to the home country** (**repatriation of profits**), pressure on **resources and the environment**, the MNC may leave if conditions change, and cultural influence.

Exchange rate changes

An **exchange rate** is the **price of one currency in terms of another** (for example, $1 = 280 rupees).

- **Appreciation**: the currency **rises in value** (it buys more foreign currency).
- **Depreciation**: the currency **falls in value** (it buys less).

Effect on businesses (exchange rate calculations are not assessed; you need the *effects*):

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	Currency appreciates (stronger)	Currency depreciates (weaker)
Exporters	exports **cost more abroad**, so **less competitive** and sales may fall; profit per unit falls	exports **cheaper abroad**, more competitive, higher sales
Importers	imports **become cheaper**, costs fall	imports **become dearer**, costs rise (raw materials, components)
Overall	good for importers, bad for exporters	good for exporters, bad for importers

An **exporter** that earns foreign money loses when that money buys fewer units of home currency. A business that **imports materials** and **exports goods** has effects in both directions.

TRY IT

Explain how a depreciation in the exchange rate might affect a business that imports raw materials and sells in the home market. The currency buys less foreign currency, so the imported materials become **more expensive** in home-currency terms. Costs rise, which squeezes profit unless the business raises prices, and higher prices may reduce sales to customers. It is not helped as an exporter, because it sells at home.

Note Academy