Understanding business activity

Why businesses exist, adding value, primary, secondary and tertiary sectors, public and private sector, enterprise and business plans, business size and growth, failure, types of business organisation and business and stakeholder objectives.

A **business** is an organisation that uses **resources** (land, labour, capital, enterprise) to produce **goods or services** that people want. This chapter looks at what businesses are, how they are classified and organised, and what they are trying to achieve.

NOTE

How Business Studies is marked. Longer answers earn marks for four skills: **Knowledge** (a correct point or definition), **Application** (using the business in the question), **Analysis** (explaining *why* or *how*, with a chain of reasoning) and **Evaluation** (a justified judgement). A "**Recommend and justify**" question needs a decision, reasons for it, and a reason why the alternative is weaker. Always use the **name of the business and the figures** in the case.

1.1 Business activity

Needs, wants, scarcity and opportunity cost

- **Needs** are things essential for survival (food, water, shelter). **Wants** are things people would like but can live without.
- **Scarcity**: resources are **limited** but wants are **unlimited**. So people and businesses must choose.
- **Opportunity cost** is the **next best alternative given up** when a choice is made. If a business spends $50,000 on a new machine, it cannot also spend it on advertising: advertising is the opportunity cost.

Specialisation

Specialisation means workers, businesses or regions concentrate on what they do best (**division of labour**). It raises **output and productivity** because workers become skilled and faster. **Limitations**: boredom, and workers who rely on one skill may find it hard to move jobs.

Purpose of business activity

Businesses **produce goods and services** to **satisfy needs and wants**, to **make a profit**, and to **provide employment**. They do this by **adding value**.

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Adding value

Added value = **selling price – cost of the bought-in materials and services**.

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> A baker buys flour, eggs and sugar for $2 and sells a cake for $9. **Added value = $9 – $2 = $7.**

Ways to increase added value: raise the **price** (through branding, quality, packaging), cut the **cost of inputs** (find cheaper suppliers) or produce a **higher-quality or more convenient** product.

1.2 Classification of businesses

Economic sectors

Sector	Activity	Examples
Primary	**extracting** or growing natural resources	farming, fishing, mining, oil extraction
Secondary	**manufacturing** and construction: processing raw materials into products	car factories, bakeries, building
Tertiary	**services**	banking, teaching, transport, retail, healthcare

A bakery that grinds its own flour combines sectors, and many businesses fit more than one. Classify by the **main** activity.

Changing importance: in **developing economies** the primary sector is usually largest; as an economy **develops**, the secondary sector grows (industrialisation), and in **developed economies** the **tertiary** sector is the largest, as incomes rise and people spend more on services and manufacturing moves abroad.

Private and public sector

- **Private sector**: businesses **owned by individuals or groups** whose main aim is usually **profit** (sole traders, companies).
- **Public sector**: businesses **owned and controlled by the government** (public corporations such as a state railway or national health service), usually aimed at providing a service.
- A **mixed economy** has both.

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1.3 Enterprise, business growth and size

Enterprise and entrepreneurship

An **entrepreneur** is a person who takes the **risk** of starting a business. **Enterprise** is the skill of doing so.

Characteristics of successful entrepreneurs: risk-taker, hard-working, determined, creative or innovative, confident, good at communicating and organising, willing to learn from failure.

A business plan is a written document setting out the business's aims and how it will achieve them. It usually contains: the **business idea and aims**, **market research** and the **target market**, the **marketing plan**, **operations** plan, **staffing**, **sources of finance** and a **cash-flow forecast**. It **helps entrepreneurs** by making them think through the idea, and **persuades banks and investors** to lend.

Why and how governments support start-ups: because new businesses create **jobs, tax revenue and competition**. Support includes **grants**, **low-interest loans**, **training schemes**, **advice** and **tax breaks**.

Measuring business size

Method	Limitation
Number of employees	misleading if the business is highly automated (few workers but large output)
Value of output (sales)	prices and inflation distort comparisons
Capital employed (money invested)	different industries need different amounts of capital
Market share	depends on how the market is defined

(**Profit** is *not* a measure of size: a small business can be highly profitable.)

Why businesses grow, and remain small

Why owners want growth: higher **profits**, **economies of scale** (lower average costs), more **market share** and power, lower risk through **diversification**, and the owner's status.

Ways to grow:

- **Internal (organic) growth**: expanding from within, by selling more, opening new outlets or launching new products. Slow but low risk and keeps control.
- **External growth**: **merging** with or **taking over** another business. Fast, but costly and risky (clashing cultures).

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Problems of growth: **diseconomies of scale**, poor communication, loss of control, cash-flow problems from heavy investment. **Solutions**: improve communication, delegation, careful financial planning, hire skilled managers.

Why some stay small: the owner wants control and a **quiet life**; a **niche** or **personal-service** market; not enough **finance**; the market is too small.

Why businesses fail

Causes: **lack of management skills**, **poor cash flow (liquidity problems)**, **changes in the business environment** (new competitors, changes in fashion, recession), low demand, poor location, rising costs. **New businesses** are at greater risk because they have **no track record or reserves**, are **short of finance**, lack **experience** and **customer loyalty**, and may be hit by cash-flow problems early on.

1.4 Types of business organisation

The main forms

Form	Features	Advantages	Disadvantages
Sole trader	owned and run by **one person**; **unlimited liability**	full control, keeps all profit, simple, private	unlimited liability, limited finance, long hours, no continuity
Partnership	**two or more** owners (usually 2–20); unlimited liability; deed of partnership	shared skills, finance and workload	unlimited liability, **disagreements**, shared profits
Private limited company (Ltd)	**shareholders** own it; shares **cannot be sold to the general public**; **limited liability**	limited liability, raises more capital, continues if owner leaves	shares hard to sell, less control for owner, more legal rules, accounts available
Public limited company (plc)	shares **sold on the stock exchange**; limited liability	can raise **large sums**, easy to sell shares	**takeover risk**, loss of control, costs and strict rules, **short-termism** (pressure for quick profit)
Franchise	a business (the **franchisee**) **pays to use** a well-known brand and system from the **franchisor**	tested business idea, brand and support	fees and a share of profits, **limited independence**
Joint venture	two businesses **share** a project and its costs, risks and profits	shared risk and expertise, access to new markets	disagreements, profits shared

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Unincorporated businesses (sole traders, partnerships) have **no separate legal identity** from their owners, so the owners have **unlimited liability**: they are **personally responsible** for all debts, even if that means selling their home. **Limited companies** are **separate legal entities**: shareholders can lose **only the money they invested**. This is **limited liability**.

Risk and ownership: the greater the owner's personal risk, the greater the control, but the more they stand to lose.

Public sector organisations include **public corporations** (owned by the government, run by a board, funded partly by the state, aims such as providing services and jobs).

> **Recommend and justify a form of ownership: link the owners' needs (control, risk, funds needed, number of owners) to the features of the form, then say why another form is less suitable.**

1.5 Business objectives and stakeholder objectives

Business objectives

Objectives are **targets** that give direction and let managers **measure success**. They can **change** over time (a new business aims for **survival**; once secure it targets **growth**).

Objective	Meaning
Survival	staying in business, especially for new firms
Growth	increasing size, sales or the number of outlets
Profit	revenue minus costs; the main aim of most private firms
Market share	the percentage of total market sales a firm has
Others	customer satisfaction, **social and environmental** goals, quality

Social enterprises exist mainly to achieve a **social or environmental purpose** (for example, employing disabled people, fair-trade coffee), reinvesting their profits, while still needing to make enough money to survive.

Stakeholders

A **stakeholder** is anyone **affected by or with an interest in** a business.

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Group	Type	Typical objective
Owners / shareholders	internal	profit and dividends, growth in value
Managers	internal	salary, status, job security
Employees	internal	good pay, job security, good conditions
Customers	external	quality, low prices, good service
Suppliers	external	regular orders, prompt payment
Lenders (banks)	external	repayment with interest
Government	external	taxes, jobs, obeying the law
Local community	external	jobs, no pollution or noise

Conflicts: stakeholders' objectives often clash. Owners want **higher profit**, which may mean **lower wages** for employees or **higher prices** for customers; customers want low prices, suppliers want high prices; the community wants less pollution, which raises costs.

Private and public sector objectives

Private sector: mainly **profit**, growth, survival, market share. **Public sector**: mainly to **provide a service** (healthcare, transport) at an affordable price, create **employment**, and cover costs rather than maximise profit.

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