BUSINESS OPPORTUNITIES

Enterprise

WHY DO PEOPLE START THEIR OWN BUSINESS?

- to gain a profit
- to turn a hobby or pastime into a business
- to use redundancy money and provide themselves with employment
- to be their own boss.

NEEDS

People have a limited number of needs that must be satisfied if they are to survive. These would include physical needs such as a minimum amount of food, water, shelter and clothing and psychological and emotional needs, e.g. self-esteem and love.

WANTS

Wants are unlimited (infinite) people constantly aim for a better quality of life. For example, better/more food, better housing, longer holidays, better education, entertainment – in effect any example that is not a basic need.

BUSINESS OPPORTUNITIES

Needs and wants are not fixed. They can change quickly as fashions and lifestyles change, and also over the longer term as incomes increase and population changes. This means that markets are always changing. The business world does not stay still – new opportunities are constantly arising. An entrepreneur with an idea, commitment, funds and a little luck can succeed even in the most competitive of markets.

ENTREPRENEUR

Definition: An entrepreneur is someone who starts and runs a business. Perhaps they make a product and then sell that product, or perhaps they provide a service. They quite possibly employ people and, of course, try to make a profit.

CHARACTERISTICS OF AN ENTREPRENEUR

- being a risk taker – they risk capital
- product knowledge
- be hard working
- be passionate/determined/ambitious and have perseverance – new businesses have low success rates
- taking the initiative and being proactive – adapting to change if required
- having creativity and innovation – being able to come up with concepts and ideas
- being an effective organiser – organises labour, raw materials, etc.

IMPORTANCE OF THE ENTREPRENEUR TO THE SUCCESS OF THE ECONOMY

- Entrepreneurs tend to be single-minded, prepared to work hard, passionate/determined/ambitious, have ability to organise production, are prepared to take risks and are innovative – possible use of examples of entrepreneurs to illustrate points.
- Many entrepreneurs are innovators. They bring new ideas to the market and drive the development of new technologies. James Dyson, of Dyson vacuum cleaner fame is a classic example of an entrepreneur, bringing a range of new products to the market.
- Entrepreneurs are important because they are innovative, they can provide better ways of doing things and can also lead to new business, thus increasing profit for businesses and their stakeholders.
- Entrepreneurs have the vision and the willingness to take risks which drive business forward.
- Entrepreneurs help the economy by creating new jobs.
- Help to boost the economy by providing new products.
- Without entrepreneurs, our economy would not benefit from the boost they give from added business and ideas and wealth creation.
- Increasing exports – helps balance of payments.
- Government benefiting from taxation that is generated from the revenues of the business.

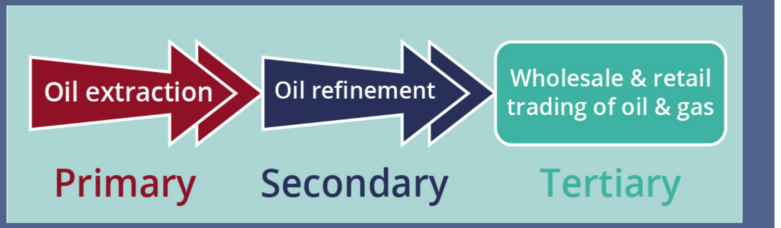
BUSINESS OPPORTUNITIES

SECTORS OF INDUSTRY

Primary: extractive – produces raw materials, e.g. iron ore (that goes into making steel) and oil (that makes petrol, plastics, etc.), as well as producing final products like fish and oranges.

Secondary: manufacturing and construction industries make, build and assemble products.

Tertiary: services give value to people but are not physical goods. Services are sometimes classified as direct services (to people), e.g. the police, hairdressing, etc. and commercial services (to business), e.g. business insurance, financial services, etc.



THE IMPORTANCE OF EACH SECTOR OF INDUSTRY TO THE UK ECONOMY

- In terms of employment, the tertiary sector **is by far the most important in the UK** employing approximately 80% of those who are in employment. The secondary sector accounts for 18%, with 2% in the primary sector. A similar picture emerges if we look at the contribution each sector makes to the value of our output (GDP).

- Many entrepreneurs believe that that **manufacturing in the secondary sector creates wealth when compared to the service sector**. However, the secondary sector in the UK and the manufacturing sector in particular have rapidly declined due in part to competition from cheap foreign imports from developing countries. They cannot compete with low labour costs in China and India.

- The key issue for the secondary sector is that of **ensuring they can turn raw materials**, or semi-finished components, **into something that consumers will pay for**. The problem is about maintaining competitiveness by adopting suitable strategies and investing in high tech industry (computers, telecommunications, aerospace) where there is a significant emphasis on research and development.

- Within the secondary sector, there needs to be a greater emphasis on hi-tech manufacturing industries and the UK needs to build on its success in this area so that it can manufacture goods for export and earns money for the UK in the future. This is important in helping UK's balance of payments.

- The tertiary sector has **grown considerably** over the past twenty years and it can be argued that the tertiary sector is the most important even if the banking crisis and the recession have shown that an over dependence on financial services has not generated as much wealth for the UK as was supposed.

- In some rural areas e.g. West and mid Wales, Scottish Highlands the primary sector is **crucial** to the local economy. We also still get a great deal of food from the UK agricultural industry, even though numbers employed are very small.

RISE/DECLINE IN EMPLOYMENT SECTORS

Primary: Declined as raw materials have run out and are now found elsewhere in the world.

Decline in secondary employment:

- **De-industrialisation** – decline in once prosperous industries such as shipbuilding, steel, textiles and car manufacturing.
- **Changes in consumer demand in favour of foreign goods** – better quality products from countries like Japan, Korea, etc. at very competitive prices/better quality/reliability/innovation.
- **Lack of competitiveness of UK manufacturing** firms in world markets/increasing overseas competition.
- **Lack of investment in manufacturing** both by government and industry.
- **Technology has replaced workers**.
- **Trade union problems** can cause markets to be lost to foreign competition.
- **Relocation of UK manufacturers** abroad due to lower costs.
- **Education system not producing as many graduates**, e.g. engineers who are able to work in manufacturing – manufacturing has become 'unfashionable'.

Increase in tertiary employment:

- **Tertiary business created** businesses that did not exist until fairly recently, e.g. fitness centres, internet cafes, on-line shopping services.
- **Greater affluence** during that period has led to growth in demand for services – finance, travel, leisure, etc.
- **Education system** more geared to tertiary employment.
- **Manufacturing has become 'unfashionable'**– people wish to work in more pleasant environments.

BUSINESS PLANS

THE BUSINESS PLAN

Definition: A statement that outlines the way in which a business will attempt to achieve its objectives - giving a clear idea of its operation and direction.

ADVICE AVAILABLE TO START UP BUSINESSES

- **Business Wales**
  https://businesswales.gov.wales/
  This is a government run website-based information resource for those individuals who are thinking of starting a business or wanting to grow their business and are seeking information, advice and guidance.

- **Commercial Banks**
  Many of the high street banks offer a dedicated service to small businesses and offer advice on how to construct a business plan and gain financial approval.

- **The Princes Trust**
  https://www.princes-trust.org.uk/
  They work with 18 to 30-year-olds to turn big ideas into a business reality through their Enterprise programme, and offer training and mentoring support to funding and resources.

- **British Chambers of Commerce**
  http://www.britishchambers.org.uk/
  They provide continued advice and support for local businesses. The BCC is a strong campaigning voice for the interests of business, delivers services that help business grow, and is the premier private sector source of advice and support for international trade.

CORE PART OF THE BUSINESS PLAN

- **The introduction or overview/Executive Statement**
  This provides an overview of the business's aims, objectives and strategy, and is evidence that the proposal is viable. It sets out how the business is going to be run.

- **The Marketing Plan**
  Important part of any business plan based on both field and desk research. Market research carried out needs, if possible, to establish the size of the market, the needs of the customers and the level of competition. When market research findings have been examined then the marketing plan can be prepared.

- **The Operations Plan**
  Include details of where the business will be located, production methods and any equipment needed. Plus, information on the costs of production and where the business will buy supplies may be included.

- **The Human Resources Plan**
  The number of employees and the skills, experience and qualifications they require will be outlined. Any management team will also be identified.

- **The Financial Plan**
  A variety of forecasting will be necessary:
  - a sales forecast indicating potential revenues
  - a cash flow forecast for the first 12 months
  - a profit and loss and balance forecast for the end of the first year
  - a break-even analysis.

  In addition, information on where the finance for starting and running the business will come from, indicating the available start-up capital as well as any potential borrowing.

DOES A BUSINESS PLAN GUARANTEE SUCCESS?

Benefits of having a business plan:

- ☑ **Sets out their objectives and strategy** - outlines the way in which they will attempt to achieve their business objectives.
- ☑ **Outlines its marketing strategy** – researches vital information such as the size of the potential market, the strength of the competition, etc.
- ☑ **Clear idea of direction and operation** – Strategic planning/setting objectives.
- ☑ **Helps to convince banks and lending institutions** of its ability to pay back loans – cash flow forecast – without one, obtaining finance from banks, etc. is less likely.
- ☑ **Highlights strengths and identifies possible problems** which can then be dealt with in advance.
- ☑ **Sets out what personnel/skills** will be required to run the business effectively.
- ☑ **Helps them think ideas through** – giving a clear idea of direction and operation. May help to identify difficulties that may occur and allow the business to deal with them before they become a problem.
- ☑ **Useful as a monitoring tool** – e.g. compare actual performance with forecasts in the business plan.

However:

- ☑ May succeed if the product or service proves so popular that sales are very high, and profits are made consistently.
- ☑ May succeed without one if a small, easily managed business e.g. window cleaner.
- ☑ No business can be guaranteed success however good the business plan.
- ☑ External factors may make the business successful even if business plan not drawn up – economic upturn, change in the law/government policies.

Those businesses that have a clear plan are more likely to be successful compared to those that do not.

MARKETS

MARKETS

A meeting place between buyers and sellers where goods and services are exchanged, usually for money.

MARKET SHARE

Definition: This measures the sales of a business relative to the market size. It is calculated using:

$$\frac{\text{Sales of a business}}{\text{Total sales in a market}} \times 100$$

The sales can be measured either in financial terms or volume (the number of items).

Market share is important as it **might indicate that a business is the market leader**. This might influence the strategy or objectives of the business. A business with a small market share may set a target of increasing its share by a certain amount over a fixed period of time. Market share might be an indication of the success or failure of a business or its strategy.

Importance or having a high market share:

- Helps business to meet business objectives, e.g. survival, growth, profit maximisation, increased market share.
- Increases businesses overall profitability. Link between market share and profitability.
- Able to benefit from economies of scale.
- Can become the brand leader.
- Edge over competitors.
- Attract new shareholders.
- Investment into research.

GLOBAL MARKETS

Definition: Global marketing is all about selling goods or services to overseas markets. Different marketing strategies are implemented, based on the region or country the company is marketing to.

Advantages:

☑ **Higher earnings** – likely to be higher earnings, if margins in overseas markets exceed those at home.

☑ **Spread risks** – by moving into new markets risks are now spread.

☑ **Economies of scale** – this move into global markets is likely to lead to increased economies of scale.

☑ **Survival** – some businesses need to be global to survive.

☑ **Saturation of the home market** – the business may have the finance to expand, but be unable to do so because of competition so they take advantage of entering a new market.

SEASONAL MARKETS

Many markets have large seasonable variations. Classic examples are ice cream (during the pre-summer period), fireworks and diet plans (in January).

Seasonal marketing will have a huge influence on the activities of businesses involved in these industries as each will have a critical sales period, which can make or break a business.

Few businesses are totally immune to seasonality of sales. Lines of stock are adapted and changed – the big supermarkets have titled seasonal aisles.

All of these seasonal changes have to be thought about and planned several months in advance to ensure that all aspects of the marketing mix are in place when required.

TRADE [B2B] MARKETS

- Trade marketing is the marketing role that focuses on selling and supplying to distributors, retailers, wholesalers, and other supply chain businesses **instead of the consumer**.
- Objective of trade marketing is to **increase demand** for products/services supplied within the supply chain.
- Trade marketing **is not an alternative** to brand and consumer marketing, but rather **acts as a support** to traditional consumer-focused marketing strategies.

MASS MARKETING

Definition: Mass marketing involves a business aiming products at a whole market, rather than particular parts of them, for example, tomato ketchup, tea bags, ITV, Vauxhall Astra, washing powder.

Advantages:

☑ A company can **produce large numbers of relatively standardised products** – the cost per unit should be low so can benefit from economies of scale.

☑ **Untargeted marketing can be used,** such as in national newspapers and on national television.

☑ **Low-cost operations**, heavy promotion, widespread distribution and the development of market-leading brands are key features.

Disadvantages:

☒ A business must be able to **produce goods on a large scale** – this is expensive to set up.

☒ If demand should fall, the **business will be left with unused resources.**

☒ Products need to be **heavily differentiated** from the competition as can be very fierce, as Coca Cola and Pepsi Cola clearly show.

MARKETS

NICHE MARKETING

Definition: A niche market is a specialized market segment where you cater for the demand for products/services that are not currently being supplied by the main suppliers. It is essentially a narrowly defined market segment.

Advantages:

☑ Businesses can **charge higher prices**/premium prices that customers are prepared to pay. Therefore, profit margins may be larger.

☑ Able to **sell to markets that have been overlooked or ignored by other businesses** – can avoid competition, at least in the short run. The great advantage of being the sole supplier in your target market.

☑ By targeting specific market segments a business can **focus on needs of their customers** in these segments, thereby is providing a better product or service – can get 'closer' to the customers.

☑ **Promotion costs can be kept lower** as the business can focus on a specific target group, unlike other forms of promotion which tends to aim at a broader segment of the population.

☑ In a recession, niche markets may have characteristics which enable them to **weather difficult trading conditions.**

Disadvantages:

☒ Businesses that successfully exploit a niche market often attract competition.

☒ By their nature, niche markets are small and are often unable to sustain two or more competing businesses.

☒ Cannot benefit from economies of scale.

☒ Large businesses joining the market may benefit from economies of scale which small businesses are unable to achieve.

☒ Does not allow the spreading of risks – are often over-reliant on one product and so are vulnerable to changes in taste, fashion, economic downturn.

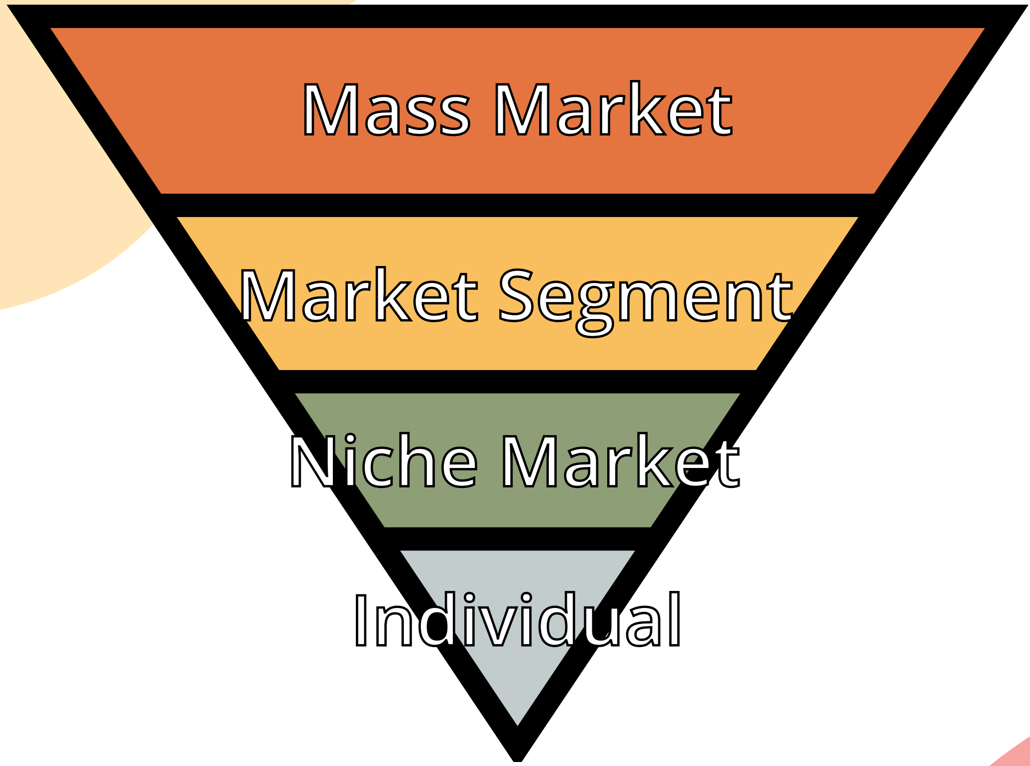
☒ As they have a small number of customers, they tend to face bigger and more frequent swings in consumer spending. Rapid growth in sales can often be followed by rapid decline in sales. Can be volatile.

☒ High prices charged in current economic climate could lead to switching purchases.

☒ Hard to expand.

☒ Smaller market/limited profit.

☒ Harder to raise finance – by the very nature of a niche market they are considered a high-risk business.



MARKETS

MARKET SEGMENTATION

Definition:
- Market segmentation is breaking down a market into sub-groups that share similar characteristics.
- Identifying and targeting of groups of people with similar needs and developing products or services for each of them.

Methods of segmentation:
- **DEMOGRAPHIC**
  - **Gender** – products may be targeted at a specific gender group. Traditionally, cosmetics have been targeted at women and DIY at men.
  - **Age** – Banks offer different accounts to different age groups.
  - **Socio economic groups/social class** – linked to occupation and income groups.
- **GEOGRAPHICAL**
  - **Regions of the country** – rural, urban, suburban. Global marketing often requires different products for different countries. Global brands such as McDonalds and Coca Cola require different ingredients in different countries.

PSYCHOGRAPHIC
  - Allows targeting of groups on **personality and emotionally based behavior** – attitudes, opinions and lifestyles. For example: Differentiating cars by emphasising different features – safety and capacity for the family car.
- **Personality and Lifestyle** – people are grouped according the way they lead their lives and the attitudes they share – e.g. young professionals may drive sports cars to project their image.
- **Culture - Religion/Ethnic grouping** – e.g. food, clothes.
- **Political voting preferences**

RULES OF MARKET SEGMENTATION

- Segments must be **recognisable**.
- Must be **different enough** from other segments to make producing for that segment worthwhile.
- Segments must have **critical mass**. This means that they must be big enough or produce enough sales value to make the production of products or services targeted at the segment worthwhile.
- Segments have to be **targetable**. Having their own identity means that they can be promoted to, and have marketing directed towards them.

BENEFITS TO THE CUSTOMER OF MARKET SEGMENTATION

- receive a product that is closer to their expectations
- can help them stick to their desired principles
- can fit better with their budgets and lifestyle
- can be superior to the competition
- can make them feel that they are getting value for money
- because marketing is targeted – the consumer is aware of new features of products.

BENEFITS TO FIRM OF MARKET SEGMENTATION

- Businesses would hope to **gain greater knowledge** about its customers so that it can vary its products to suit their needs – the information will allow businesses to sell more products and make more profit.
- Can **identify requirements/match the needs of different groups more precisely** – therefore allowing them to meet needs of different segments more effectively than the competition.
- Can **target their advertising** to specific groups, thereby maximising its effect – avoids wasteful marketing activities that are not targeted.
- To develop profiles of the different markets.
- Can **increase brand loyalty** because customers appreciate that their needs are being met.
- **Higher profits** – can develop premium segments in which customers accept higher prices.
- Supports the development of niche markets.
- Prevents products being promoted to the wrong people, which would waste resources and possibly lead to losses.
- Can **adjust the product to consumer preferences** – thus maximising potential of market share.

MARKETS

MONOPOLY

Characteristics:
- **A single producer within a market** – one business has 100% of the marketplace. This is known as a pure monopoly.
- Likely to **erect barriers** to prevent others from entering their market.
- Monopolists are called **price makers** as they have a significant influence on price.
- UK and EU regard any business with over 25% of the market as having potential monopoly power.

What could be the impact in the removal on a monopoly?
- may be greater choice of provider
- increased competition may force prices down
- greater efficiency may result as a result of competition
- isolated or non-profitable inaccessible locations may be denied a service
- prices may rise, the businesses previous economies of scale may no longer apply.

MONOPOLY COMPETITION

Definition: the situation in a market in which elements of monopoly allow individual producers or consumers to exercise some control over market prices.
Characteristics:
- A large number of relatively small businesses in competiton with each other.
- There are few barriers to entry.
- Products are similar but differentiated from each other.
- Brand identity is relatively weak.
- Businesses are not price takers, however they only have a limited degree of control over the prices they charge.

Within every monopolistic market sector each business tries to offer something different and possess an element of uniqueness, but all are essentially competing for the same customers.

OLIGOPOLY

Characteristics:
- There are many businesses but **only a few dominate** the market.
- Each business tends to have differentiated products with a **strong brand identity**.
- **Brand loyalty** encouraged by the use of advertising and promotion.
- Prices can be stable for long periods, **short price wars** do occur.
- **Some barriers to entry** do exist. For example, high start-up costs in relation to manufacturing.

Many of our largest industries are oligopolistic in nature.
- In retailing, the grocery market is dominated by Tesco, Sainsbury's, Morrisons and Asda.
- In clothing retailing, each age group have just three or four major chain stores that dominate their marketplace.

Cartels: When businesses in an oligopolistic market act together (collude), a cartel is formed. Cartels try to keep prices high, whilst the businesses involved share the market between themselves. This type of collusion has occurred in a wide range of industries. For example, the airline industry and the sports clothing industry. This formal collusion is illegal.

Advantages of an oligopoly to consumers:
☑ large size leads to economies of scale
☑ high profits means money for innovation and investment
☑ oligopolies targeting a wide range of market segments provide variety and choice.

PERFECT COMPETITION

Definition: a market in which many small firms produce virtually identical products at similar prices. With the ability to enter and leave the market freely. They don't earn excessive profits.

Characteristics:
- There are a large number of businesses competing and **no one business is large enough to influence the activities of others**.
- There are **no market leaders and no price leaders**, so each business must accept the going price on the marketplace – they are price takers.
- **The goods sold are homogenous** – there is no difference between the goods sold by one business or any other business. This means that there is no branding, **no product differentiation**, no way of telling goods apart.
- Businesses have **equal access to technology**, meaning that they have equal levels of productivity and each business will benefit in the same way from any economies of scale that are available.
- Consumers in a perfectly competitive market have **full market information**, they know what is being sold and the price the goods are sold at. They can access a wide number of suppliers to the market.
- Businesses are free to leave or enter the market at any time: there are no barriers to entry or exit.

Note to remember:
These **unrealistic conditions** mean that perfect competition is **merely a model**.
In reality, there is **always** some sort of **branding** or differentiation – whether it is the quality of products, price of products or the location of where products are sold. It has some use as the starting point to analyse the behaviour of other market structures in the real world.

MARKETS

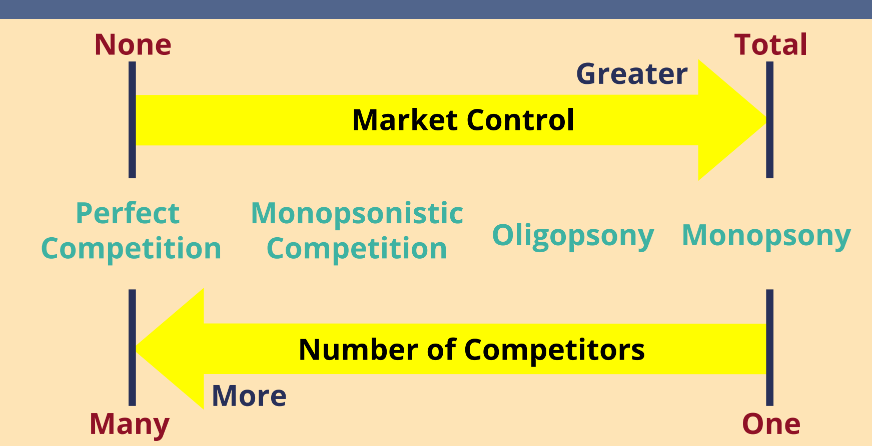
Competition increases as the number of businesses in the market increases:

Monopoly → Oligopoly → Monopolistic competition → Perfect competition

Characteristic	Monopoly	Oligopoly	Monopolistic Competition	Perfect Competition
Number of Independent Sellers	One	Few	Many	Many
Seller Concentration	Very High	Medium or High	Non – existent or low	Non-existent
Product Differentiation	No close substitutes available	Substitute may or may not be available	Products are close substitutes	Homogeneous product
Barriers to Entry	Impossible entry or barred	Very difficult to enter	Relatively free or easy entry	Free or easy entry
Pricing Power	Price maker – constrained by demand curve and possible regulation	Price maker but interdependent behaviour	Price maker – but actual and potential competition limit is pricing power	Price taker (passive)
Non-price competition	Not needed therefore large businesses are able to afford to undertake costly research and development	Very important – Businesses try to differentiate and compete through advertising, offers, product quality	Considerable emphasis on advertising, brand names, trademarks	None
Examples	Local utilities	Petrol retailing, TV broadcasting, chocolate manufactures, steel	Retail trade, dresses, shoes	Agriculture

TO WHAT EXTENT CAN THE GROCERY MARKET IN THE UK BE REGARDED AS OLIGOPOLISTIC?

- Industry/market where supply is concentrated in hands of relatively few suppliers - grocery retail trade dominated by four large players – Tesco/Asda/Sainsbury/Morrison.
- Alongside a few large suppliers, there may be large numbers of very small businesses – there are thousand of small retail grocery stores.
- Businesses are interdependent – the actions of one will affect another. If Tesco cut its price of petrol how will the other supermarkets react?
- Differentiated products - each of the dominant businesses have strong brand identity that differentiates their products from their customers.
- Indulge in non-price competition – the large grocery retailers do this – note the amount of television advertising carried out by the large retail chains.
- Tend to have high barriers to entry due to high set-up costs – in the retail trade there is freedom of entry for retailers, however, the economies of scale (bulk buying enjoyed by Tesco, etc.) constitute a real barrier.
- Could argue the idea that a monopoly is defined as a business that has 25% of the market therefore is Tesco a monopoly?



MARKETS

WHY DO CONSUMERS NEED PROTECTION?

The relationship between consumers and producers is not a relationship that is based on a level playing field. The advantage in almost all purchasing and consumption situations lies with big business.

- **Businesses** understand how to manipulate customers' behaviour; they try to control price and competition in the market place and are in the position to produce goods and services that perhaps do not fully meet the expectations of the consumer.
- **Legislators** (law makers) and consumer protection groups argue that without a strong legal framework, businesses will operate in a way that will maximise their profits with little consideration of the impact this will have on customers.
- This may seem extreme; after all there are many businesses that focus on brand value, customer satisfaction, quality of service and quality of product. Not all businesses would voluntarily keep to the highest of marketing principles, however.
- Laws are needed to protect consumers and limit the worst excesses of capitalist behaviour. To assist in the protection of consumers there are two separate groups of regulations:
    - **Legislation to protect consumers** who enter into contracts with retailers or producers. A contract is made when goods or services are purchased.
    - **Legislation with regard to competition policy**. This is large-scale policy designed to control the way that markets operate.

CONSUMER PROTECTION LEGISLATION

When consumers purchase goods or services, contracts are formed between the consumer and the retailer and the producer of those goods or services. To clarify the nature of these contracts and to establish the requirements of producers and retailers, a series of laws have been passed.

SALE AND SUPPLY OF GOODS ACT 1994

- The Act states that goods must be of merchantable quality, fit for their intended purpose, lasting for a reasonable amount of time and be as described.
- This means that the goods must be capable of doing what they were designed to do and what the purchaser would reasonably expect them to be able to do.
- For example, if you purchase a new car it must be capable of reliably transporting its driver and passengers.

CONSUMER CREDIT ACT 1974

- Controls the way that goods can be bought and sold on credit.
- Under this act the use of APR was established. APR is the annual percentage rate of interest – this must be clearly stated when credit is being offered. The use of APR allows consumers to easily compare competitive interest rates and to judge the true cost of borrowing.
- This act established the use of 'cooling-off' periods, where in many cases consumers have 14 days in which they are able to change their mind about entering into a credit arrangement.

TRADE DESCRIPTIONS ACTS 1968 AND 1972

- Designed to prevent and criminalise giving untrue or misleading descriptions of goods with regard to their content, size, weight and price.
- Because of this legislation, manufacturers and retailers have to take a great deal of care about information presented on the packaging of their goods, or within advertisements and any other form of promotional material.

DISTANCE SELLING REGULATIONS

- **Protects consumers who buy over the phone or online**. If businesses break these regulations then the consumer is not bound by the purchase contract.
- Provides the consumer with a cancellation period of 14 days (the '**cooling off' period**), during which consumers are entitled to change their minds and cancel the contract and receive a full refund, regardless of whether the product is defective.
- Consumers are **not bound by charges** they have not expressly agreed to, such as hidden delivery or card payment costs.

THE COMPETITION AND MARKETS AUTHORITY (CMA)

Consumer protection legislation is fully enforced by the courts, but to further assist the consumer there are various organisations to help ensure that the law is abided by.

- **On a national basis**, the CMA works to encourage the establishment of voluntary codes of practice within industries. For example, ABTA (Association of British Travel Agents) and ATOL (Air Travel Organisers' Licensing) protect and reimburse holidaymakers if their travel company ceases trading (if the company is a member).

- **On a local basis**, Trading Standards Departments and Environmental Health Departments work to help ensure obedience to the legislation. For example, Trading Standards officers are often found touring markets and car boot sales checking for sales of counterfeit goods.

Legislation with regard to competition policy: Controlling the power of big businesses. If businesses in a monopoly or near monopoly are able to hold a dominant market position, then they are likely to have control over price or the amount produced within the market. Governments will put in place laws and regulators to limit the potential abuse of market power thus protecting consumers.

One role of the CMA is to examine situations where companies act together, forming an illegal cartel to limit the competition within an industry. Businesses, if they have a choice, will not compete on price and they may take the view that by creating a dominant market position by working with other large businesses, they can limit price competition. Because of the potential of cartels and collusion between businesses, legislation allows for guilty parties to be fined up to 10% of turnover for each year of illegal activity.

THE ROLE OF THE OMBUDSMAN

- If a customer has a complaint that in their view has not been satisfactorily dealt with by the business concerned, the next step in finding redress might be the Ombudsman Service.
- The Ombudsman Service can be used to complain if consumers have an issue with pricing, quality of service, quality of goods or mistreatment.
- In a number of industries, including financial services, communications (e.g. phones and the internet), energy (e.g. gas and electricity) and property (e.g. estate agents and surveyors), the ombudsman findings are binding and the business concerned must comply with the ruling.

ETHICAL ISSUES RELATED TO CONSUMER PROTECTION

Businesses also need to consider the ethics of their relationships with customers. **Consumers can be manipulated** by businesses and their marketing professionals. Subliminal advertising (placing fleeting or hidden images in films or TV programmes in the hope that viewers will process them unconsciously) was banned in the 1970s, but that does not stop the unscrupulous from taking advantage of natural human reactions.

Product placement is when a company pays a TV channel or a programme-maker to include its products or brands in a programme. This is allowed but there are rules from Ofcom (the broadcasting regulator) on how this is done. For example:
- no product placement can be carried out on children's TV programmes and certain products such as cigarettes and alcohol are not allowed.
- it used to be standard for all supermarkets to have displays of sweets and chocolates next to checkouts: children would use 'pester power' to get their parents to buy sweets whilst they queued.

Being ethical in marketing is always a problem area for those businesses producing and marketing consumer products. It can be a difficult balancing act for businesses to try to maximise sales whilst, at the same time, marketing their products in a way that does not encourage overconsumption or excessive behaviour by customers.

Some businesses have had to try to reinvent themselves because their marketing has been seen as unethical. McDonalds 'supersize' was once a marketing winner, but with increased worries about people's weight problems, the campaign was dropped. McDonalds now focus a large part of their advertising and product development on healthier meals.

MARKETS

DEMAND

Definition: the amount of a product that consumers are willing and able to purchase at any given price.

The law of demand states: the higher the price, the lower the quantity demanded, and the lower the price, the higher the quantity demanded.

SUPPLY

Definition: the amount of a product that suppliers will offer to the market at a given price.

The law of supply states: all else equal, an increase in price results in an increase in quantity supplied.

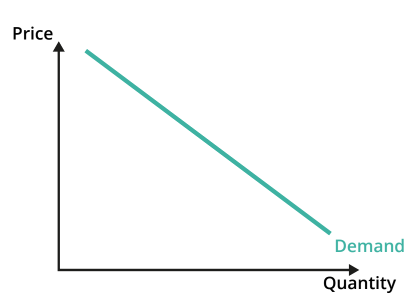
FACTORS THAT CAUSE THE DEMAND CURVE TO SHIFT - PASIFIC

- **P** Population
- **A** Advertising
- **S** Substitutes (price of)
- **I** Income – general level
- **F** Fashion and Taste
- **I** Interest Rates
- **C** Complements (price of)

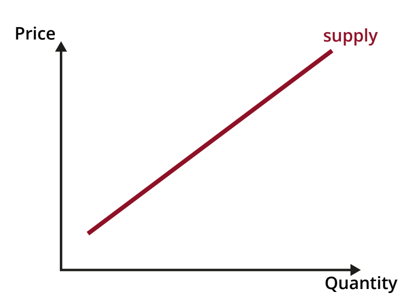
FACTORS THAT CAUSE THE SUPPLY CURVE TO SHIFT - PINTSWC

- **P** Productivity
- **I** Indirect Taxes
- **N** Number of Firms
- **T** Technology
- **S** Subsidies
- **W** Weather
- **C** Cost of Production

DEMAND CURVE

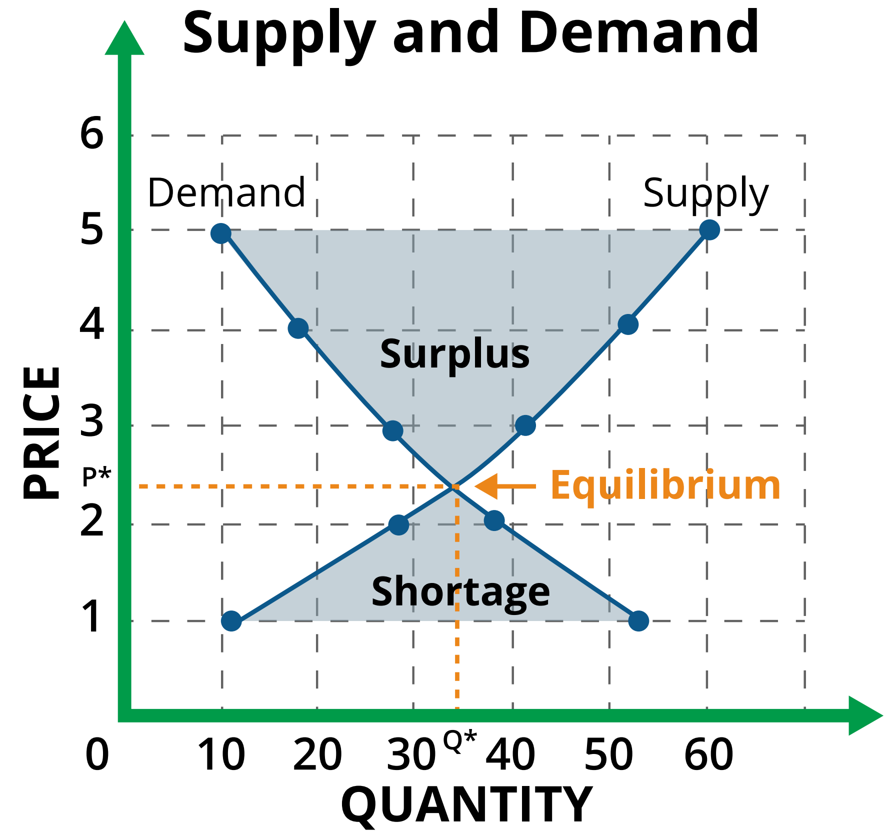


SUPPLY CURVE



EQUILIBRIUM PRICE

Definition: In a free market, demand and supply equal the equilibrium price. This is the price where quantity demanded is equal to quantity supplied.

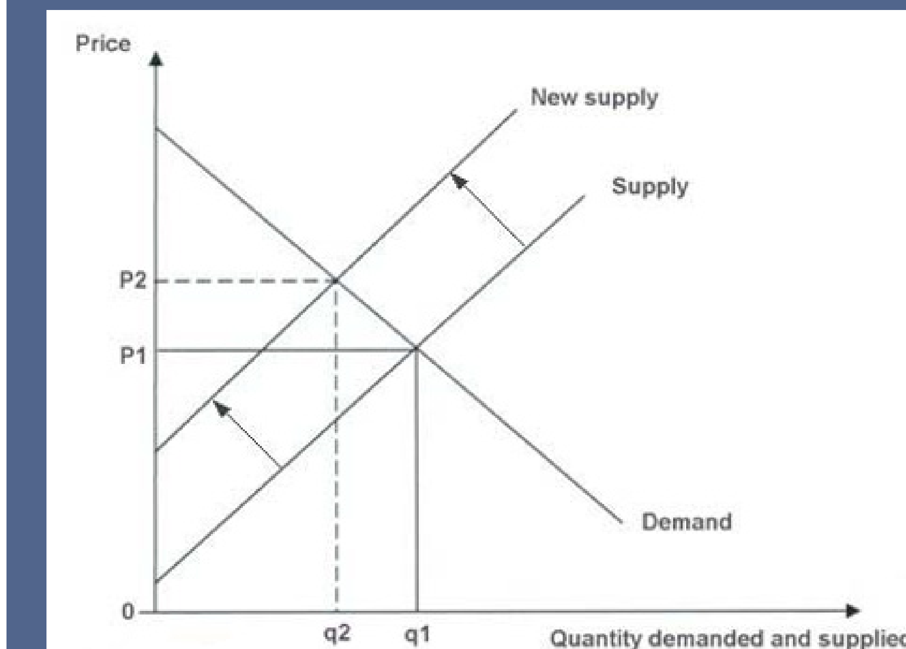


EXAMPLE QUESTION OF SUPPLY AND DEMAND

CHILE'S WINE INDUSTRY DEVASTATED BY QUAKE

The earthquake on 28 February 2010 destroyed major parts of Chile's Central Valley. Southern ports were closed and, inside dozens of wine stores, a river of wine soaked into the soil. The big wine storage vats toppled over and wine stored in barrels rolled off the racks, cracked open or popped their seals. Initial estimates put the quantity of lost wine at 12% of wine production and 20% of Chile's stored wine, but the true figure is likely to be much higher than this.

Adapt the diagram below and explain why the price of Chilean wine might rise.



- a leftward shift in supply curve
- marking of new equilibrium price and equilibrium quantity
- the evidence, i.e. earthquake destroys large percentage of wine, suggests that the supply curve shifts to the left – this will lead to an increase in price to P2 because at price of p1 demand exceeds supply.
- new equilibrium formed where 'New Supply' cuts original demand curve.

MARKETS

ELASTICITY OF DEMAND

Definition: The relationship between changes in **demand**, changes in **price** and **income** is known as the elasticity of demand.

PRICE ELASTICITY

Definition: measures the **sensitivity of demand to a change in price**. Price elasticity is **always negative** as the increase in price will lead to a fall in sales and, conversely, a reduction in price will lead to a rise in sales.

Formulae:

$$\frac{\text{Percentage change in quantity demanded}}{\text{Percentage change in price}}$$

A value **greater than 1 is called price elastic**, whist a value of **between 0 and 1 is called price inelastic**.

Price Elastic: a product where a proportionate increase or decrease in price leads to a proportionately greater increase or decrease in the quantity sold, i.e. its elasticity is greater than one.

Examples: Hovis bread, Heinz soup, Aero chocolate bar – they all have alternatives that can be bought!

Price Inelastic: where a proportionate change in a products price leads to a proportionately smaller change in the quantity sold, i.e. elasticity is greater than zero but less than one. Such products tend to have high product differentiation, meaning that consumers perceive them as having no acceptable substitutes.

Examples: Petrol, salt, tap water, cigarettes

Price inelastic – a change in price causes a smaller % change in demand.

Price elastic – a change in price causes a bigger % change in demand.

INCOME ELASTICITY

Definition: measures how sensitive demand is to a change in income.

Formulae:

$$\text{Income elasticity} = \frac{\text{Percentage change in quantity demanded}}{\text{percentage change in income}}$$

Income elasticity of demand can be grouped into three categories:

1. **Normal goods** – as real incomes increase, the demand for normal goods will also increase: positive income elasticity less than one.
   Examples are matches, lemonade, newspapers.
2. **Luxury goods** – the demand for luxury goods will grow at a faster rate than the increase in real income that created the change in demand: positive income elasticity that is greater than one. Examples are holidays abroad, health club membership, sports cars.
3. **Inferior goods** – these are cheap substitutes of products people prefer to buy when their income is reduced (such as value line baked beans): negative income elasticity.

Examples:

Normal Goods	Luxury Goods	Inferior Goods
Fresh vegetables	International air travel	Frozen vegetables
Instant coffee	Fine wines	Cigarettes
Natural cheese	Luxury chocolates	Processed cheese
Fruit juice	Private education	Margarine
Spending on utilities	Private health care	Tinned meat
Shampoo/ detergents	Antique furniture	Value 'own-brand' bread
Rail travel	Designer clothes	Bus Travel

DISCUSS THE USEFULNESS OF THE THEORY OF INCOME ELASTICITY OF DEMAND TO A MANUFACTURER OF DIGITAL TELEVISION SETS

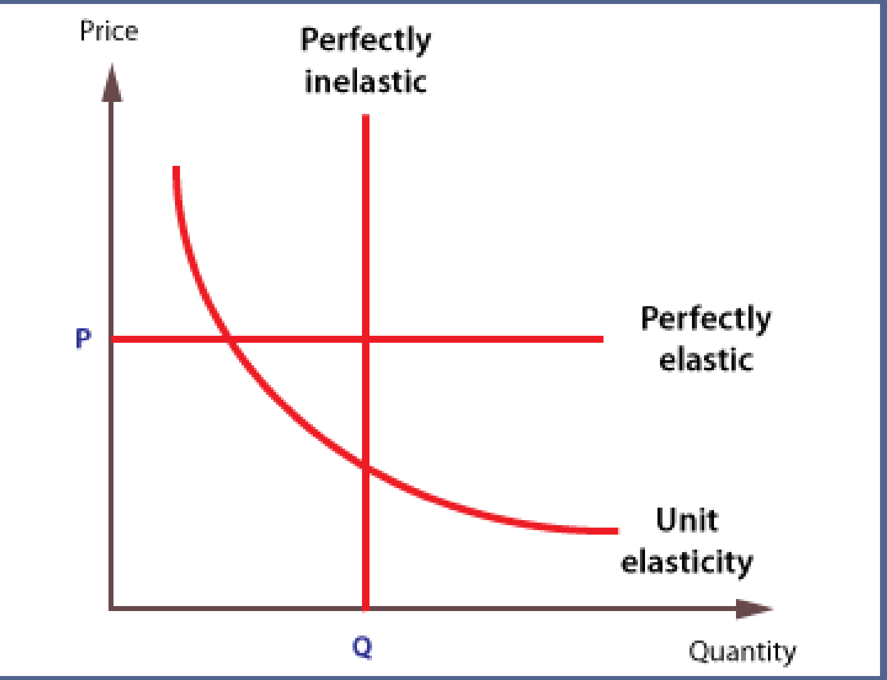
The theory might be useful to a manufacturer of TV sets because it will help to predict future sales.

If it is anticipated that incomes will rise by a certain amount, then it might be expected demand for digital TV sets to rise more than proportionately.

This would enable the manufacturer to make sure that the production capacity was sufficient to meet the anticipated demand.

However, there may be reasons why predictions based on past performance are unreliable:

- A new technology may be developed and customers will buy that instead. For example, the increasing use of computers to view television on demand.
- Economic circumstances may change and consumers have less disposable income.
- There is no guarantee, even if the overall market increases in size as predicted, that any one manufacturer will maintain their share of the market, e.g., Japanese manufacturers have lost market share to lower cost producers in Korea and Taiwan.



MARKET RESEARCH

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WHY DO PEOPLE START THEIR OWN BUSINESS?

Definition: the process of gathering primary and secondary data on the buying habits, lifestyles, usage and attitudes of actual and potential customers.

General Benefits of Market Research:

- ☑ Can identify opportunities and threats, i.e. changes.
- ☑ Can be used to monitor sales after a promotional campaign.
- ☑ Can help them find alternative routes to overcome a problem.
- ☑ Identify target market.
- ☑ Reduce risk of failure.

General Drawbacks of Market Research:

- ☒ Research does not guarantee success.
- ☒ It is costly in time.
- ☒ Often all that is needed is good intuition or a hunch.
- ☒ Costs money.
- ☒ Research can be unreliable.

Businesses regard **having an understanding of the market place as a major priority.** This is because of the following factors:

- the **expense** of launching new products
- the **importance** of maintaining market share
- the **importance** of preserving the profile and brand value of existing products.

They need to **understand** their markets, in order to design products and marketing campaigns that meet the needs of customers.

WHY CARRY OUT EXTENSIVE MARKET RESEARCH

Reasons for:

- ☑ An **aid to decision making** – helps to make informed decisions especially important in fast changing markets.
- ☑ To **find out about customer wants and expectations.**
- ☑ To **suggest introduction of new products,** modification of existing products.
- ☑ To **find out how much customers are willing to pay**/developing pricing strategies.
- ☑ To **gain competitive advantage/keep** pace with competitors/find out what they are doing.
- ☑ **Predictive reasons** – what is likely to happen in the future.
- ☑ **Exploratory reasons** – investigating new possibilities in a market.
- ☑ **Descriptive reasons** – what is happening in the market? Who is buying which products in our portfolio?
- ☑ **Explanatory reasons** – for example to find out why have sales fallen in the last six months.
- ☑ Carrying out market research means that consumers may feel that their views are being considered.
- ☑ **Reduces risk** – without market research a business may spend large sums of money developing and launching unsuccessful products.

Reason against:

- ☒ Market research may predict that an idea/product will succeed but this is not always the case - primary research depends upon responses of consumers who may not respond in the same manner in the future.
- ☒ **Data can be based on an unrepresentative sample** – sampling discrepancies caused by statistical bias. A poorly constructed questionnaire can also lead to bias.
- ☒ In secondary research, **data does not always meet specific needs** of a business.
- ☒ Primary research **can be expensive** to gather and businesses may have to pay for secondary research.
- ☒ Secondary data **can be outdated** – especially problematic in fast-changing industries.
- ☒ Research data, especially primary can be **time consuming to gather.**

MARKET RESEARCH

PRIMARY RESEARCH

Definition: (field research) – collecting primary data and information that does not already exist. It is collected for a specific purpose. Most primary information is gathered through questionnaires, interviews, surveys, focus groups and consumer panels.

Advantages:

- ☑ The research carried out is only available to that business – this will enable it to gain market advantages over rival firms.
- ☑ It is up to date information, thereby enabling better decision making.
- ☑ It can be targeted for specific needs that the business may have identified.

Disadvantages:

- ☒ Can be very expensive to collect – could the money have been better utilised using secondary research.
- ☒ Can be very time consuming to collect so that by the time it has been collected and analysed the market may have changed.
- ☒ Can have problems of bias.

SECONDARY RESEARCH

Definition: (desk research) – identifies, collects and collates information that is already in existence. This can be collected internally or externally. It may be existing business documents, official publications, yellow pages, industry magazines and online desk research.

Advantages:

- ☑ It is inexpensive to collect and quick to obtain.
- ☑ Enables cost-effective analysis of several data sources.

Disadvantages:

- ☒ Often out of date.
- ☒ Might not be available.
- ☒ Little control over quality.
- ☒ Problems of interpretation.

QUANTITATIVE RESEARCH

Definition: Involves the collection of data that can be measured. This means the collection of statistical data such as sales figures and market share. *Surveys and the use of government publications/existing statistics are common methods of collecting quantitative research data.*

- Researcher uses tools, such as questionnaires and surveys to collect numerical data.
- Researcher knows clearly in advance what they are looking for.
- Recommended during latter phases of research projects.
- Is usually regarded to be less open to interpretation than qualitative data (objective).
- Data is in the form of numbers and statistics.

QUANTITATIVE RESEARCH

Definition: Involves collection of data about attitudes, beliefs and intentions. *Focus groups, participant observation and interviews are common methods used to collect qualitative data.*

- Researcher may only know roughly in advance what they are looking for.
- Recommended during earlier phases of research projects.
- Can be time consuming to collect and may be difficult to draw general conclusions.
- Information gathered is often open to high degree of interpretation (subjective) and so there is often disagreements within business about the significance and importance of qualitative data.
- Data is in the form of words, pictures or objects.

Marketing is linked to all the other functional departments of a business:	
Human Resource	Marketing will influence the numbers and skills of employees required.
Production	Marketing helps to determine what to produce, when to produce it and how much money can be spent producing it.
Finance	Marketing generates the money for the firm through sales revenue and helps to forecast future sales revenue.
Purchasing	Marketing will influence how much in the way of raw materials will be needed.
Transport	Marketing will influence the number of lorries and drivers required.

MARKET RESEARCH

SAMPLE

Definition: a group of respondents to a market research exercise who are selected to be representative of the views of the target market as a whole.

QUOTA SAMPLING

Definition: the population is segmented into a number of groups that share specific characteristics.

- The sample is often segmented on the basis of age or sex. This is known as the demographic profile.
- Therefore, if it is known that 20% of your buyers are men, interviewers would be instructed to interview one man for every four women in the sample.
- This is a relatively cheap method of sampling compared to many others.
- Results using quota sampling cannot be regarded as statistically representative of the population – they are not randomly chosen.

RANDOM SAMPLING

Definition: every member of the population has an equal chance of being interviewed.

- This is not easy to achieve and must not be confused with haphazard sampling.
- Random samples are drawn from local electoral registers and interviewees are contacted at home.
- The interviewer must call three times before giving up on the address – this is to overcome the fact that busy people are those least likely to be at home at certain times.
- Attempting to achieve randomness in this way creates expensive fieldwork costs so many businesses tend to adopt quota sampling instead.

SAMPLE SIZE

The size of the sample used is very important as it needs to be large enough to make the data statistically valid.

- If sample size is large, the research will take a long time and may be very expensive.
- If the sample size is too small, then there is a greater chance that random factors will make the results inaccurate.

This gives large businesses with big marketing budgets a significant advantage over smaller businesses – a good example of an economy of scale.

BIAS

Definition: something that may cause data within a sample to be weighted towards one side. Such statistical bias occurs when one subgroup outweighs the other in a sample.

To avoid bias and collect data that is statistically valid, sampling methods, such as random sampling and quota sampling, must be used to determine the market research sample.

With questionnaires (as with all forms of research) it is important to gather data from a sample that reflects the whole population.

BUSINESS STRUCTURE

PRIVATE SECTOR

The private sector includes all these businesses that are set up by individuals or groups of individuals, e.g. sole traders, partnerships, companies, charities and cooperatives.

PUBLIC SECTOR

The public sector is essentially business activity that is owned/ run by the government for the benefit of everyone, e.g. army, police force, schools, hospitals.

GOODS

Definition: items produced by the conversion of raw materials into finished products by the secondary sector. They are **tangible/physical products**, e.g. a car.

- **Consumer Goods**: Goods that are used by the consumer.
- **Producer Goods**: Items that are bought by another business and used to help make other goods, e.g. photocopier, JCB.

- **Single Use**: Items that can only be used once, e.g. ice cream, coffee.
- **Durable**: Items that can be used over and over again, e.g. car, kettle.

SERVICES

Definition: intangible, a task performed in return for payment. This includes personal/ direct services,
e.g. hairdresser/haircut, and commercial services, e.g. banking and insurance services.

BUSINESS AIMS AND OBJECTIVES

Aims: The long-term intentions that provide a focus for setting objectives. They are usually expressed qualitatively, sometimes in the form of a mission statement.

Objectives: The medium to long-term targets that can give a sense of direction to a manager, department or whole organisation,e.g. boost market share from 8% to
10% within the next 3 years.

Private sector aims:
- survival
- profit maximisation
- maximizing growth
- gaining market share
- maximising sales revenue
- maximising shareholder value
- diversifying into new products/new markets
- social aims
- ethical aims
- improving reputation
- improved quality
- environmental
- increased efficiency
- competitiveness.

Public sector aims:
- provide a universal service to all UK households wherever they are located
- provide a service that the private sector may not be willing to provide as it may not be profitable to do so
- to make a trading surplus if possible
- provision of merit goods to raise society's standard of living
- to ensure effective provision of public goods.

PUBLIC GOODS

Definition: Public goods are goods that would not be provided in a free market system, because businesses would not be able to charge for them.

Public goods have two main characteristics:
- **Non-rivalry** – the consumption of the good by one individual does not reduce the amount available for others, e.g. social services.
- **Non-excludability** – it is impossible to exclude others from benefiting from their use, i.e. people who use the street will benefit from the street lighting provided.

Examples include: defence, social protection - police, street lighting, flood control, lighthouses and public water supplies.

MERIT GOODS

Definition: Merit goods are goods that could be provided by the free market but policy makers recognise that they would be under-consumed.

There are external benefits in providing these goods and services and they are provided free of charge by the Government

Examples include: health, education, libraries, museums, roads.

IMPORTANCE OF THE PUBLIC SECTOR

- Goods and services needed in our everyday lives (public goods) would not be provided by the private sector who are looking to make profits. For example: street lighting, defense (army, navy, air force) and the police.
- We all benefit from them without paying for them.

BUSINESS STRUCTURE

SOLE TRADERS

Definition: Owned and run by one individual but they may employ people.

Advantages:

☑ **Independence/own boss** – wants to take own decisions and take responsibility rather than being told what to do. This makes decision-making quick as the sole trader has full control.

☑ **Wants to develop the skills acquired** in the building industry/has acquired sufficient knowledge and understanding to give them the confidence to set up their own business. Natural progression. Wants to achieve something for themselves.

☑ **To increase rewards** – a sole trader may believe they will earn more than if he continues to be employed in the building industry.

☑ **Privacy of business affairs** – there is no legal requirement to share how the business is performing with anyone.

Disadvantages:

☒ unlimited liability

☒ more responsibility

☒ relies heavily on their own ability to make decisions

☒ may work long hours and have limited holidays as there is no one to cover them

☒ limited sources of resources.

REASONS WHY WOULD SOMEONE SET UP THEIR OWN BUSINESS

- **Financial reward:** The opportunity to become better off/earn more than current employment/keep the profit/do not have to split the profit with anyone.
- **Independence:** Enjoy being in control rather than being employed/greater degree of flexibility.
- **Personal satisfaction:** Building your own business may help individuals reach the higher goals in life.
- **Prefer to work on their own:** One man/women businesses are not uncommon.
- **Interest:** May be passionate about the product or service they provide.
- **May take over a family business:** Wish to keep it going to support family and employees.
- **Identifying gap in the market:** Can exploit an opportunity/to increase wealth.
- **Lack of employment opportunities:** People made redundant and unable to find alternative work.
- **Encouragement by external/government agencies to set up own business:** Support and advice offered by agencies, e.g. GO Wales, Career Wales, Princes Trust.

PARTNERSHIPS

Definition: Owned and run between 2–20 people.

Deed of Partnership: The partners may choose to draw up a 'Deed of Partnership', which is a legal agreement setting out the rights and responsibilities of the partners. It covers issues such as:

- how much capital each partner will contribute
- how profits (and losses) will be shared amongst the partners
- the procedure for ending the partnership
- how much control each partner has
- rules for taking on new partners.

Advantages:

☑ can share resources and ideas

☑ can cover for each other (during holidays for example)

☑ have more sources of finance

☑ have shared responsibility and decision-making.

Disadvantages:

☒ unlimited liability

☒ loss of control

☒ slow decision-making

☒ disagreements between partners

☒ profits must be shared between partners.

BUSINESS STRUCTURE

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PRIVATE LIMITED COMPANIES [LTD]

Definition: Often a small business. Shares do not trade on the stock exchange.

Advantages:

- ☑ Benefit of limited liability – if the business fall into debt then the owner is not held responsible and their personal possessions are safe.
- ☑ Can attract extra shareholders to invest because of limited liability.
- ☑ Control cannot be lost to outsiders – shares are only sold by word-of-mouth so the owners have to invite people to buy the company shares.
- ☑ Continuity – the business does not end if a partner dies.
- ☑ Can be tax advantages if owners are paying the higher rate of income tax.
- ☑ Increased capital – the ability to sell shares can generate the capital needed to expand the business.

Disadvantages:

- ☒ Legal procedure in setting up takes time and costs money.
- ☒ Having to disclose the accounts – financial information filed with the Registrar can be looked at by public/competitors.
- ☒ Profits have to be shared with the other shareholders.
- ☒ Slower decision-making – especially if all shareholders have to be consulted.

PUBLIC LIMITED COMPANIES [PLC]

Definition: Is usually a large, well-known business. Shares trade on the stock exchange.

Advantages:

- ☑ All shareholders maintain limited liability.
- ☑ More market power maybe enjoyed due to larger size.
- ☑ Huge amounts of money can be raised from the sale of shares to the public on the stock exchange – this can be used to expand the business.
- ☑ Economies of scale may be enjoyed as the company grows.
- ☑ May gain greater presence/dominance in the market.
- ☑ Often easier to raise finance – financial institutions, such as banks, are more willing to lend to plcs.

Disadvantages:

- ☒ It can be expensive – setting up costs can run into millions for some businesses.
- ☒ Outside interests could take control as shares are on sale to the public.
- ☒ Greater divorce of ownership and control than in a private limited company. The company's board may lose control.
- ☒ Accounts can now be inspected by the public or competitors who could use them to their advantage.
- ☒ Have to publish more information than private limited companies.
- ☒ Greater size may lead to slower decision making.
- ☒ Can be time consuming to gain listing.
- ☒ If they grow too big, they may become inflexible, e.g. they may find change difficult to cope with.

SHOULD A BUSINESS BECOME A PUBLIC LIMITED COMPANY OR REMAIN AS A PRIVATE LIMITED COMPANY?

Reasons for becoming a PLC:

- ☑ large amounts of money can be raised for the business from the sale of shares to the public
- ☑ may gain economies of scale
- ☑ easier to raise loan finance helps growth – might give a business a bigger market share
- ☑ may motivate employees/managers
- ☑ brand recognition
- ☑ more capital for investing in new products.

Arguments to remain as an LTD

- ☒ setting up costs for the business would be expensive
- ☒ there would be an even greater divorce of ownership for the business between ownership and control
- ☒ a business may lose control and be involved in a takeover
- ☒ the business accounts can be inspected by the public – used by competitors
- ☒ a loss of personal touch between the business and its customers
- ☒ the business may become inflexible because of its size.

BUSINESS STRUCTURE

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WHY MOVE FROM A SOLE TRADER TO A PARTNERSHIP?

Arguments in favour of a partnership

- ☑ potentially more capital – ideal for example if the business needs to find new premises as the current one is becoming too small
- ☑ a new partner brings new skills
- ☑ possibility of specialisation
- ☑ more ideas/problems can be shared
- ☑ share workload – presents an opportunity to reduce working hours/take holidays
- ☑ avoids need to employ somebody – a risk – new staff need training – not sure of their capabilities.

Arguments against forming partnership (staying as a sole trader):

- ☒ original sole trader will lose their independence
- ☒ will need to share profits – though possible to generate more
- ☒ could result in disagreements/quarrels - though many family businesses are successful others end in acrimony
- ☒ decision making potentially slower – need to consult/less flexibility
- ☒ by employing a new worker, the original sole trader could retain their independence and also reduce their own working hours
- ☒ If, after a short time, the new partner finds they want to leave the partnership, then the original sole trader is back to square one.

CHARITIES

A non-profit-making organisation established with the aim of collecting money from individuals and spending it on a cause, which is usually specified in its title:

- not established to make profits but they can earn surpluses
- charities can often have a narrow focus (single issue) in what they are trying to achieve
- charities raise the majority of their finances through voluntary donations, but more and more charities now operate retail outlets as well.

WHY MOVE FROM A SOLE TRADER TO A PRIVATE LIMITED COMPANY?

- ☑ potentially a lot more capital available for expansion
- ☑ greater protection for personal assets – benefit of limited liability
- ☑ easier to attract investors/shareholders because of security of limited liability
- ☑ becomes a separate legal entity
- ☑ likely to have greater continuity
- ☑ possibly greater credibility with financial institutions
- ☑ can still keep control
- ☑ shareholders may bring in additional business ideas.

But:

- ☒ loss of certain advantages associated with being a sole trader e.g. keeping all of the profit, may now need to consult when making key decisions
- ☒ will need to consider the fact that they will need to publish accounts so that business affairs are less private
- ☒ possibly less control over business – separation of ownership and control – but the sole trader can remain majority shareholder
- ☒ cost of setting/private limited company setting.

SOCIAL ENTERPRISES

Definition: Social enterprises include for-profit and not-for-profit businesses (e.g. cooperatives) with primarily social objectives, **trading for social and environmental purposes**, whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners.

Operating in what has become known as the "Third Sector" (neither public not private sector). They are usually charitable trusts, founded for a social purpose. They reinvest their profits in the company or the community, and attempt to change lives for the better.

Examples: Jamie Oliver's 15, Big Issue, Fair-trade Divine Chocolate, worker cooperatives, charities.

They do, however, need to make a profit to compete in the market, to ensure their continued survival, to invest in their social or environmental aims and to reduce any dependency on public grants.

- Social enterprise businesses **will seek to survive, make profit and wish to grow**. In this sense, they are not essentially different from private enterprise businesses.
- Social enterprises are **distinctive because their social and/or environmental purpose is absolutely central to what they do** – their profits are reinvested to sustain and further their mission for positive change.
- An ethical business is not the same as a social enterprise. An ethical business tries to achieve its financial goals while minimising any negative impact on society or the environment. A social enterprise's **main purpose is to fulfil its social and/or environmental goals.**

BUSINESS STRUCTURE

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STAKEHOLDERS

Definition: A stakeholder is anyone with an interest in a business. Stakeholders are individuals, groups or organisations that are affected by the activity of the business.

They include:

1. **Owner/Shareholder** – they are interested in how much profit the business makes.
2. **Managers** – they are concerned about their salary.
3. **Employees /workers** – they want to earn high wages, have job security and a nice working environment.
4. **Customers** – they want the business to produce quality products at reasonable prices and to have a variety of products/services to choose from.
5. **Suppliers** – want the business to continue to buy their products at a fair price.
6. **Competition** – they have interest in what the business is doing. If they do not "keep up" with them then they risk losing customers.
7. **Financiers/Lenders** – want to be repaid on time and in full.
8. **Local Community** – they have a stake in the business as employers of local people. Business activity also affects the local environment. For example, noisy night-time deliveries or a smelly factory would be unpopular with local residents.
9. **Government** – they are concerned with whether or not the business is operating within the constraints of the law; how many jobs the business is providing and how much tax the business has to pay.
10. **Pressure Groups/Trade Unions** – they will fight for the rights of their members and put pressure on the business to behave in a certain manner.

SHAREHOLDERS

Shareholders are the owners of a limited company. In theory, all shareholders share the common objective of sustained long-term growth, giving both capital gain and increasing income.

However, the reality is that even shareholders can come into conflict:

- Institutional shareholders (investment and pension funds) are often driven by the need to achieve in the short term. This means that they require high dividends and strategies to achieve short-term growth from the businesses that they have invested in.
- However, these strategies may be at odds with achieving long-term growth through reinvestment of profits and investing in brand value, which are what the individual, long-term investor may be looking for.

Unfortunately for the small private shareholder, the institutional view is the one that more often than not wins the day.

DIRECTORS AND MANAGERS

Directors and managers in large organisations focus their efforts on achieving the long-term objectives of the business.

They use the resources under their control to achieve maximum benefits for the business and to gain the most from the assets that they manage. Often the success or failure of the business will be reflected in the rewards they receive.

Unfortunately for some businesses, the main long-term objective of some managers is the protection of their position. This idea of self-preservation is sometimes a motivator for **middle managers** that can result in the establishment of whole layers of hierarchy whose role is to preserve their position.

Senior managers are also sometimes accused of personal objectives ahead of those of the business by attempting to maximise their salaries and benefits, whilst cutting costs through redundancies and rationalisations.

EMPLOYEES/WORKERS

Employees/workers from middle management down receive a wage and possibly fringe benefits such as pensions.

Naturally, a major concern of this category of stakeholders is **job security**. With many businesses seeking to incorporate technology and reduce the size of the workforce, there will be obvious conflicts in the views of stakeholders. In the past, this conflict would have often led to industrial action.

However, over the last two decades, it seems that the labour force has become more aware of the realities of modern employment and are therefore less likely to take part in strikes. The labour force is more willing to accept job restructuring, redundancy, the need to move jobs, relocate and retrain. However, industrial action does still take place and those employees who are members of strong trade unions are able to influence their pay and conditions to a greater extent than non-unionised workers.

BUSINESS STRUCTURE

CUSTOMERS

Customers are an increasingly important stakeholder. Satisfying customers' needs profitably should lead to financial success to satisfy the other stakeholders.

Customers want:

- **Efficient service and a quality product**, at a competitive price. These requirements should not be at odds with good business practice, but unfortunately sometimes they are. The short-term nature of businesses can mean that achievement of immediate profit comes ahead of long-term customer satisfaction.
- They like to **feel needed and respected**. It is all too easy to alienate your customer base. Maintaining good public relations is increasingly important – something that the banking and financial industry has come to realise in relation to the treatment of its customers.

GOVERNMENT

Government benefits from business success as it results in:

- increased tax revenues
- higher employment
- lower benefit payments.

However, the same economic success also means:

- increased pollution
- increased traffic
- loss of greenfield sites through development.

In the past, the priority was invariably given to growth, but increased environmental awareness has forced the government into limiting developments, encouraging development of brownfield sites and into imposing taxes such as the Climate Change Levy and the Landfill Tax. These taxes on businesses increase business costs, reduce competitiveness and potentially increase unemployment.

As a stakeholder, the government has to balance business and economic growth against external costs of business activity.

LOCAL COMMUNITIES

Local communities need to be considered as a stakeholder. There are a number of benefits to a local community that stem from local business activity:

- employment
- increased regional wealth
- improved facilities and infrastructure.

Often the economic prosperity of a community may depend on one large employer in their area – the presence of which may support a range of other businesses such as shops, garages and hairdressers.

Businesses may also support local charities as well as being involved with local schools and colleges.

However, conflicts can also occur between local communities and the businesses that operate close to them:

- potential pollution
- environmental damage
- loss of open space.

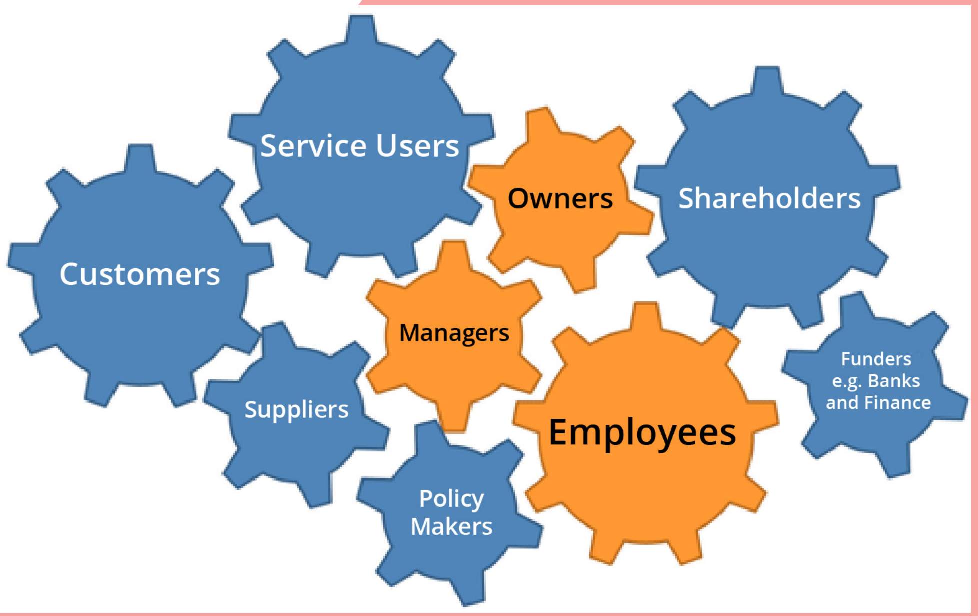
For example, heavy transport moving 24/7 can affect the peace and quiet of a community.

SUPPLIERS

Suppliers depend on the success of businesses for their sales – businesses depend upon suppliers in order to carry on their operations. They are mutually dependent.

Suppliers want a fair price for their products whilst businesses wish to minimise costs:

- Following supply and demand theory, each market should achieve an equilibrium price, which should allocate rewards between supplier and buyer efficiently in a competitive market.
- However, unfortunately for suppliers, the power in the market often rests with the buyer, and we are seeing this market imperfection more and more.
- The big four supermarkets dominate the UK's farming industry, continually forcing down the prices they pay to producers, reducing farm incomes (for example, consider the recent milk price war and its impact).
- The situation is often worse when suppliers are based in developing countries, with the original producer receiving a tiny proportion of the product's final sale value. Fair trade goods try to make the supplier–buyer relationship more balanced.



BUSINESS LOCATION

Definition: Location for new and existing businesses is still largely determined by:
- access to customers
- access to factors of production
- minimisation of costs.

COSTS

Most important location factor is likely to be the cost. The setting up of a new business will incur a number of location costs including:
- planning permission
- purchasing or rental/leasing
- refurbishment
- business rates
- labour costs
- transport costs.

- New businesses, especially sole traders, have limited capital to start off with therefore they may not be able to afford the ideal of their choice.
- New businesses need to consider the importance of location on its success.

SOCIAL REASONS

- Managers want to live in an environment that suits them and their families.
- Managers can often retain a commitment to their existing workforce, even when it makes economic and business sense to relocate a business.

THE MARKET AND COMPETITION

- The **market** is the place where buyers and sellers meet. Most commercial B2C exchanges (buying and selling in consumer markets) still take place face-to-face, so a physical location is required.
- Retail location should be driven by access to customers but there will be a balance between customer **footfall** and rental/lease costs.
- Costs of location will vary according to likely sales and customer potential, but within each price band there will be both good and bad locations.
- An **anchor tenant** is usually the first and the leading tenant in a shopping center whose prestige and name recognition attracts other tenants.
- Being in **close proximity to competitors**, a business can benefit from their marketing efforts.
- Manufacturers of components in many industries need to be located close to the users of their products.

LABOUR

- It can be a deciding factor in determining location. By labour, its meant cost of labour, availability of labour, and the skills of labour.

- Businesses can be attracted to certain areas by the **skilled labour** that may be available. Cardiff is rapidly developing a booming media industry, which is attracting new international investors looking to recruit talented employees.

- The **cost of labour** is also a determining factor. International location has a habit of following low-cost labour to wherever it is available. Many UK manufacturing businesses have relocated to the far East and China, where labour costs are very low.

GOVERNMENT INFLUENCE

- Cost of labour can be affected by the availability of **government grants** and **government taxation policies**.

- The **availability of low cost** and **suitable land resources** can also be an important factor when determining location. National governments often ensure that planning permission is available to allow large developments to proceed. They also offer incentives like tax breaks and help with recruitment and training of employees.

BUSINESS LOCATION

INFRASTRUCTURE

- The type and quality of infrastructure also effects access to markets. Infrastructure used to mean roads, rail and shipping. However, a more modern definition includes electronic communication systems, training agencies and financial services.
- For many modern businesses, such as those that are **e-commerce** based or the rapidly growing call centre industry, quality infrastructure has a very different meaning from that understood by road hauliers and heavy goods manufacturers.
- **Economies of concentration** or agglomeration occur when a number of businesses in the same or related industries locate close together. They are able to gain mutual advantages. New businesses are attracted by existing infrastructure clusters and in high-tech industries.

INCREASED CHOICE IN INTERNATIONAL LOCATION

Footloose businesses are those that move from location to location, basing themselves wherever best suits their needs at a particular point in time:

- changing patterns of trade
- improved communications
- freer flows of capital.

All of the above mean that the largest businesses have the alternative of locating their production facilities virtually anywhere in the world. As long as there is a stable political background and an available workforce, most countries will offer the possibility of hosting a production (or even a remote service) base.

The main influences on international location beyond politics and labour force factors are likely to be:

- Maximising **economies of scale**. If businesses are able to have a single plant supplying all their requirements for a type of product or range of components, then the business's average costs of production can fall. Therefore, there are huge factories providing cakes to sell throughout Europe or producing injection-moulded plastics for distribution throughout the world. The **falling costs of international transport** have allowed this to occur.
- **Political factors** can also have an influence on location. Tariff and quota-free access to trading blocs such as the EU or NAFTA (North American Free Trade Association) may depend on setting up a production facility within that trading bloc. Far Eastern companies such as Toyota and Honda, wanting free access to European markets, have large production units in the UK today.
- Companies sometimes establish head office operations where **taxation levels** are lower than their home base. This can allow transfer costing to take place. Transfer costing is a process by which businesses are able to inflate their profits in countries where taxation levels are relatively low and decrease their profits where taxation levels are relatively high.
- **Comparative international wage levels** also need to be considered when deciding on worldwide location. High-tech industries can often choose from willing and skilled workforces from many different global locations.
- **Freedom from restrictions**, which would otherwise increase costs or constrain production methods, can be a driver of location. Businesses can reduce their costs if they locate operations in countries where red tape is less present or employment law is less strict.

BUSINESS FINANCE

SOURCES OF FINANCE

Businesses cannot survive without finance, whether in the form of initial funds to start the business:

- **Working capital** is the money needed to finance the day-to-day running of the business. It allows stock to be bought and wages and bills to be paid.
- **Investment capital** helps the business grow.
- **Capital Expenditure** – Businesses just starting up need money to invest in **fixed assets** such as buildings and equipment.

The most suitable finance option for a business depends on many things:

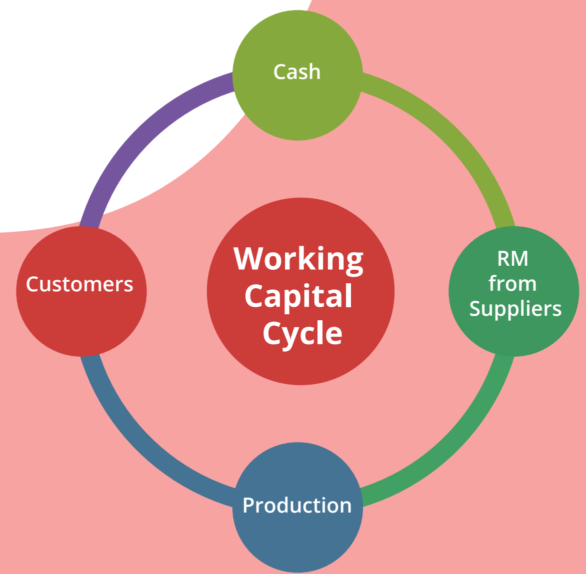
- how much funding is needed
- how long the money is required
- what the finance will be used for
- the affordability of repayments
- whether or not personal or business assets are available as security
- whether or not the business owner is willing to give up a share of ownership, perhaps through taking on a partner or selling shares.

Internal Sources: Money that is generated from within the business or from the business owners own capital:

- reinvested profits
- squeezed out of working capital
- sale of assets
- owners' savings.

External Sources: Money that is raised from sources outside of the business.

INTERNAL Sources of Finance	Advantages	Disadvantages
Retained Profit/ Own Funds	• Cheapest form of finance as you do not have to pay interest on own money. • Immediately available. • This will provide a liquidity buffer and potential funds for growth.	• Money is tied up in business so not earning interest. • Cannot use for other purposes (opportunity cost). • Reserves, reinvested profits, come with only one cost – the loss of profit distribution to owners. • Short-term pressures to pay profits to owners (normally shareholders) can, however, restrict the availability of this form of finance.
Working Capital	• By reducing their trade credit period and collecting debts more efficiently, a business may receive money from customers more quickly. • Reducing stock holdings is another way to release finance.	• This is likely to drive customers away and may have the opposite effect on making finance available. • A sudden surge in demand could result in lost sales if the business is unable to meet delivery dates.
Sale of Assets	• Established businesses are able to sell off assets that are no longer required, such as buildings and machinery.	• Smaller businesses are unlikely to have such unwanted assets and, if growth is an objective, they are much more likely to want to acquire assets as opposed to losing them.



BUSINESS FINANCE

EXTERNAL Sources of Finance	Definition	Advantages	Disadvantages
Bank Loan	A loan is borrowing a fixed amount, for a fixed period of time, perhaps 3–5 years	• If application for the loan is successful, the money becomes immediately available. • Payments made up of interest and capital are made monthly, which can help with cash flow planning. • Funds are made available for medium- to long-term borrowing of large sums of money, for example if a business needs to acquire building land. • Offering security against a loan can make it much easier to get funding and reduces interest rates charged.	• Interest has to be paid on the loan; thus, businesses have to pay back more than what they borrowed. • Very difficult to obtain for small businesses. It is likely that most new start-ups are unlikely to receive a loan unless security is offered. • Some form of collateral may be required to secure the loan – if the business owner is not able to maintain payments, homes can be lost or business assets removed.
Overdraft	An overdraft is the facility to withdraw more from an account than is in the bank account, resulting in a negative balance.	• Very useful for overcoming short term liquidity problems – useful for day-to-day transactions, easing cash flow needs and emergency requirements. • Only pay interest when account is overdrawn, i.e. do not have to pay off regular sums.	• Interest charged can be very high indeed. • The overdraft limit tends to be fairly low for small businesses. • May be arrangement fee. • Can be called in immediately – it is repayable on demand.
Trade Credit	Businesses buy items such as fuel and raw material and pay for them at a later date.	• The 30-90 days offered by suppliers can be viewed as interest free way of raising finance.	• Suppliers often offer discounts for cash or early payments, meaning the cost of goods is higher if full credit period is used. • Late payment can also lead to a business gaining a bad reputation with suppliers.
Factoring	Factoring is a method of turning invoices into cash.	• Banks and other financial organisations offer factoring services that pay a proportion of the value of an invoice (80–85%) when the invoice is issued. The balance, minus a fee, is paid to the business when the invoice is paid. • This flexible form of finance keeps pace with business growth as the funding is directly linked to the turnover of the company. • The factor will also undertake all credit management and collections work. • The use of this service results in savings in administration costs, which can be substantial and faster customer payments means lower interest costs on any overdraft facility.	• Factoring services are only offered to businesses with a good trading record and reliable customers.
Leasing	The company gains use of a productive asset, without ever owning it.	• The business acquires the use of resources without the need for a large sum of money. • The maintenance and repair bills are met by the leasing company. • Leases are generally easier to obtain than loans. • Equipment can be updated regularly.	• Over a long period of time, it can be a very expensive and well in excess of the purchase price. • The business never gets to own the items leased.

BUSINESS FINANCE

EXTERNAL Sources of Finance	Definition	Advantages	Disadvantages
Hire Purchase	Method of gaining the use of capital goods, whilst paying a monthly fee.	• Useful for purchasing machinery that can be obtained quickly. • Finance houses may also be less selective than banks. • At the end of the hire purchase period, the business will own the asset.	• Interest rates are usually very high. • The property is not owned by the business until the last payment has been made. Items can be legally repossessed if the business falls behind with repayments. • Add servicing charges for paying in instalments.
Commercial Mortgages	If a business owns property, a commercial mortgage may be available.	• With a commercial mortgage, the property is used as security against the loan and the loan can be as much as 60% or 70% of the value of the property. • Because security is being offered to the lender, the interest rates will be lower than an unsecured loan. • Payments are made monthly for the term of the mortgage. • Commercial mortgages might run for 10 or 15 years so generally have predictable costs – this can be helpful with budgeting and predicting cash flow.	• Failure to make repayments may lead to the property being repossessed by the lender.
Sale and Leaseback	This involves the business selling assets (buildings, machinery) to a finance company and then leasing the asset back.	• This method of raising finance means the capital that is produced can be reinvested into growing the business. • An asset owned by the business can be turned into capital for reinvestment in the business. • Sale and leaseback also carries potential tax benefits as the leasing costs are offset as an operating expense.	• Once the item has been sold, it is no longer an asset of the business thus it is a one time option.
Share Capital	A long-term method of providing funds for growth is to sell shares.	• Share capital is a form of permanent capital; this means it does not have to be repaid. • Owners of shares have a say in how the business is run, but the amount of influence they have depends upon the percentage shareholding they own.	• Loss of control – the business owner or owners will have decisions influenced by new investors. • New shareholder investors may be looking for an exit strategy within a few years. This means that they are expecting the business to grow rapidly and then they expect to be able to sell their shares, taking their capital gain.
Business Angels/ Venture Capitalists	Professional investors who can invest large amounts of capital into small- and medium-sized businesses.	• Possibly large sums of money can be attained quickly. • Advice may also be given.	• Will not only take a shareholding but also expect to be fully involved in running the business.
Government Grants/ Government Assistance	Both local and central government may offer finance to business start-up schemes.	• Usually given to small businesses in regions where unemployment is high. • Often, they are grants that do not have to be repaid.	• They tend to be small amounts that last only for a relatively short period of time. • They are also few and far between – tend to come with certain conditions which must be met. • Administration requirements – forms to complete that meet what can be strict criteria.

BREAK-EVEN ANALYSIS

SALES REVENUE/TURNOVER

Revenue is the money a business makes from sales. The total amount of money a business receives from its sales is called total revenue.

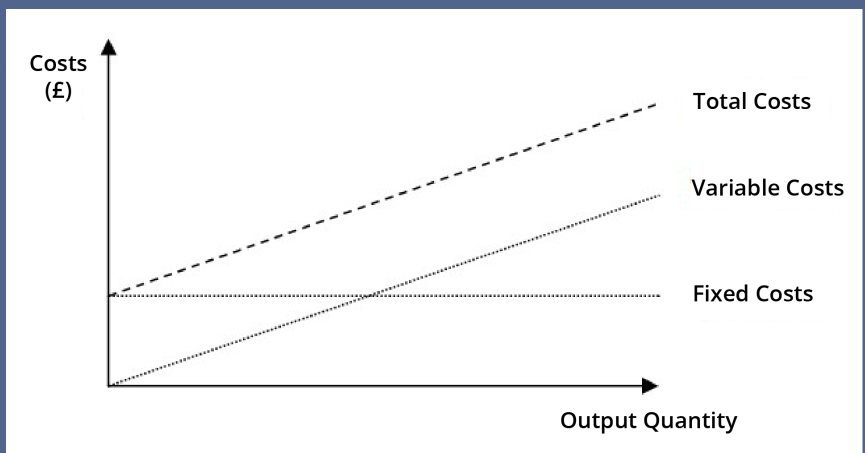
Total revenue = quantity sold x selling price

TYPES OF COSTS

Fixed Costs: Do not vary with output. Fixed costs only change in the long run. For example: rent, management salaries, interest charges and depreciation.

Variable Costs: Costs that vary in direct proportion to changes in output. For example: raw materials, fuel and labour (when staff are paid for what they produce).

Total Costs: Fixed Costs + Variable Costs



Semi-Variable Costs: Costs that contain both fixed and variable elements, such as telephone charges where there is a fixed standing charge plus an extra rate that varies according to the number of calls made.

PROFIT

Calculation: Total Revenue – Total Costs

Example: Calculate the profit made if the business was operating at maximum capacity.

Maximum possible output (100% capacity)	400 000 units
Actual output	240 000 units
Variable Costs (per unit)	£6
Fixed Costs	£360 000
Selling Price (per unit)	£14

Total Revenue = 400000 x £14
Total Revenue = £5600000

Fixed Costs = £360000

Variable Costs = 400000 x £6
Variable Costs = £2400000

Total Costs = Fixed Costs + Variable Costs
Total Costs = £360000 + £2400000
Total Costs = £2760000

Profit = Total Revenue – Total Costs
Profit = £5600000 – £2760000
Profit = £2840000

CONTRIBUTION

Definition: It is the difference between the income generated from sales and the variable costs of producing the goods to generate those sales. This allows a business to analyse whether each of its products covers its own variable costs.

Contribution is used to pay the company's overheads (fixed costs). Once these have been covered, additional contribution generates profit.

Contribution per unit =
Selling Price per unit – Variable Costs per unit

DIRECT COSTS

Definition: Costs that arise specifically from the production of a product or the provision of a service.

Examples of direct costs include:
- rent on a shop
- materials or components
- direct labour
- expenses such as copyright payments on a published book
- licence fees for use of patents.

These direct costs can be totalled to give the direct costs of producing the product. However, revenue minus direct costs does not indicate profitability. The business must also apportion **overheads** or **indirect** costs to the product.

OVERHEADS/INDIRECT COSTS

Definition: Costs not directly related to production.

Examples of overheads costs include:
- employing the secretary or receptionist
- advertising costs.

The true profitability of a product, factory, outlet etc. can only be judged if we take from revenue both direct costs and overheads.

BREAK-EVEN ANALYSIS

BREAK-EVEN

Definition: A diagram that shows the level of output where a business does not make a profit nor a loss

Calculation: $\dfrac{\text{Fixed costs}}{\text{(Selling price per unit minus variable cost per unit)}}$

Advantages:

- ☑ **Easy visual** means of analysing a business' financial position at different levels of output - gives a valuable rule-of-thumb guide to potential profitability.
- ☑ **Cheap to construct** and can be carried out quickly.
- ☑ Profit and loss situation can be **seen at a glance** – good for non-financial specialists.
- ☑ Helpful for making decisions in **'what if'** situations – can cope with changing circumstances in relation to revenues and costs.
- ☑ Break-even analysis, as part of a **business plan**, can be helpful in gaining finance.
- ☑ **Target setting** made easier.
- ☑ Can **identify the margin of safety** – aids planning

Limitations:

- ☒ Often regarded as **too simplistic** as some assumptions are unrealistic.
- ☒ It **assumes all output is sold,** which is often not the case.
- ☒ **Assumes that conditions remain unchanged** – wages, prices and technology can all change suddenly.
- ☒ **Relies on the data being accurate** and often under- or over-estimations are made.
- ☒ **Assumes that total revenue and cost curves are always linear** – this may not be the case.
- ☒ **Allocating fixed costs** in a multi-product business can be problematic – thus making break-even analysis output inaccurate.
- ☒ **Fixed costs are often stepped** – this makes break-even analysis difficult.

EXAM QUESTION

BLUE RIVER KAYAKS (BRK)

Blue River Kayaks (BRK) produces Kayaks for sale to the outdoor pursuits market.

The information below relates to the year ending 31 December 2010.

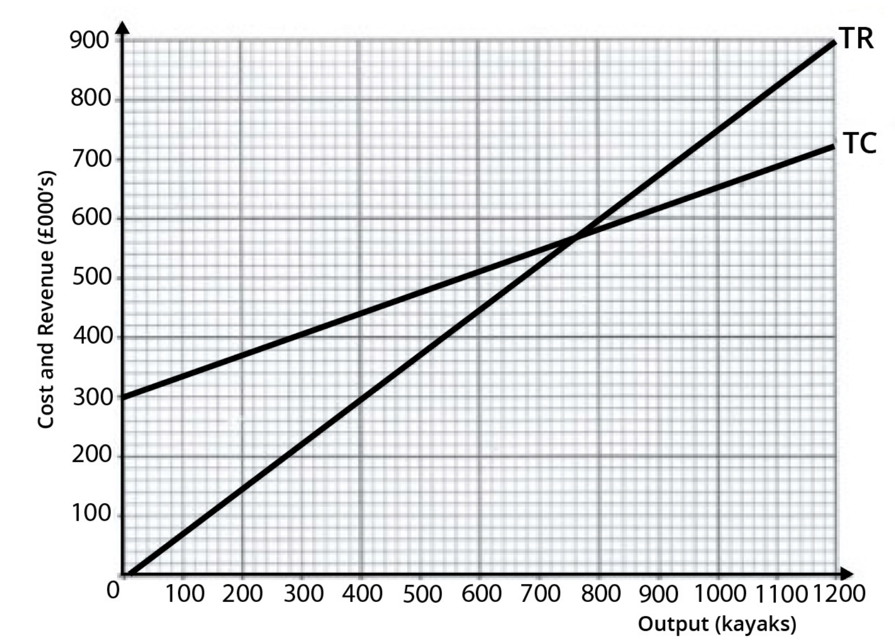
COSTS in 2010
Fixed costs = £300 000
Labour costs = £150 per kayak
Material costs = £200 per kayak

SALES in 2010 = 1200 kayaks

PRICE per kayak in 2010 = £750

The rent BRK pays for its factory is due to increase in 2011 by £20 000. Whilst the workforce has been persuaded that a rise in wages is not possible for 2011, it is estimated that material costs are likely to increase by 15%. BRK operates in a very competitive market and a 3% rise in price is as much as it feels it can charge in 2011 and yet still match its 2010 sales volume.

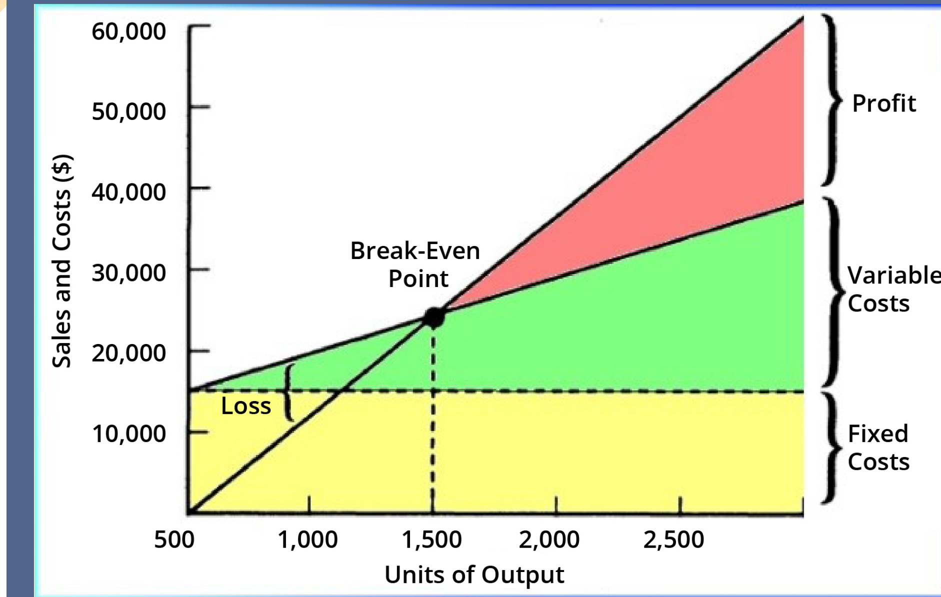
A. *Construct and label the break-even chart for the year 2010.*



B. *Based on the figures given in the passage, calculate by how much BRK's profit would change in 2011 compared with 2010.*

	2010	2011
Revenue:	1200 x £750 = £900,000	1200 x £772.50 = £927,000
Costs FC	= £300,000	£320,000
VC	= £420,000	£456,000
TC	= £720,000	£776,000
PROFIT	= £180,000	£151,000

Change in profit = (£29,000) A fall of 16% or 16.1%

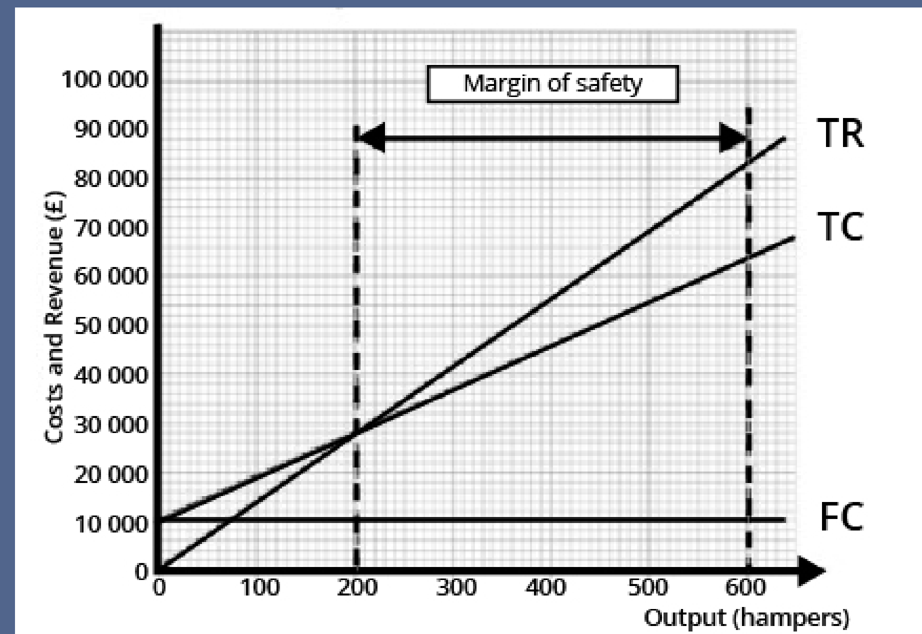


MARGIN OF SAFETY

Definition: The margin of safety shows how much a producer can reduce output before the business starts to make a loss.

Calculation:
Selected level of business activity – Break-even Point

Exam Questions: *Draw the margin of safety on the chart if all the hampers were sold in the first year.*



The margin of safety consists of how many hampers?

Margin of safety = 600 – 200
Margin of safety = 400 hampers