Cambridge

AS - Level

Business studies

CODE: (9609)

Unit 01 – Chapter 01

Business and its environment

1. Enterprise

Chapter 01

Enterprise

Introduction

This book focuses on the role of business managers in making decisions that impact their business's future success. It emphasizes the importance of understanding the economic environment and the interrelationships between businesses, their world, and government limitations. The first chapter explains the nature of business activity and the role of enterprise in setting up and developing businesses.

The purpose of business activity

A business is an organization that uses resources to meet customer needs by providing products or services. It involves creating and adding value to resources, such as raw materials and semi-finished goods, making them more desirable to final purchasers. Business activity allows us to enjoy a higher standard of living by using scarce resources.

What do businesses do?

Business activity exists to produce consumer goods or services that meet the needs of customers. These **goods** and **services** can be classified in several ways.

KEY TERMS

Consumer goods: the physical and tangible goods sold to the general public – they include durable consumer goods, such as cars and washing machines, and non-durable consumer goods, such as food, drinks and sweets that can be used only once.

Consumer services: the non-tangible products sold to the general public – they include hotel accommodation, insurance services and train journeys.

What do businesses need to produce goods and services?

Factors of production

These are the resources needed by business to produce goods or services.
They include:

KEY TERM

Capital goods: the physical goods used by industry to aid in the production of other goods and services, such as machines and commercial vehicles.

■ **Land** – this general term includes not only land itself but all of the renewable and non-renewable resources of nature, such as coal, crude oil and timber.

■ **Labour** – manual and skilled labour make up the workforce of the business.

■ **Capital** – this is not just the finance needed to set up a business and pay for its continuing operations, but also all of the man-made resources used in production. These include **capital goods**, such as computers, machines, factories, off ices and vehicles.

■ **Enterprise** – this is the driving force, provided by risk taking individuals, that combines the other factors of production into a unit capable of producing goods and services. It provides a managing, decision-making and coordinating role.

The concept of creating or adding value

All businesses aim to create value by selling goods and services for a higher price than the cost of bought-in materials, this is called '**creating value'**

The difference between the selling price of the products sold by a business and the cost of the materials that it bought in is called '**added value'**.

KEY TERMS

Creating value: increasing the difference between the cost of purchasing bough-in materials and the price the finished goods are sold for.

Added value: the difference between the cost of purchasing bought-in materials and the price the finished goods are sold for.


Timber is a natural resource


Capital equipment can be very complex


All businesses need labour

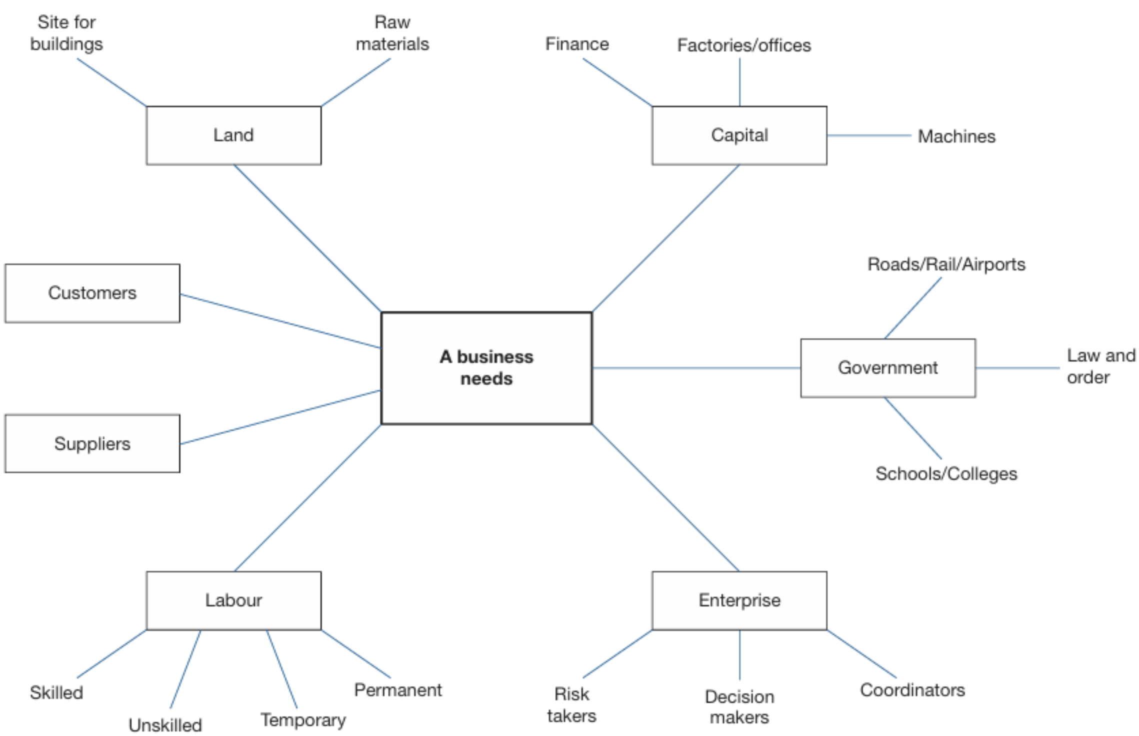
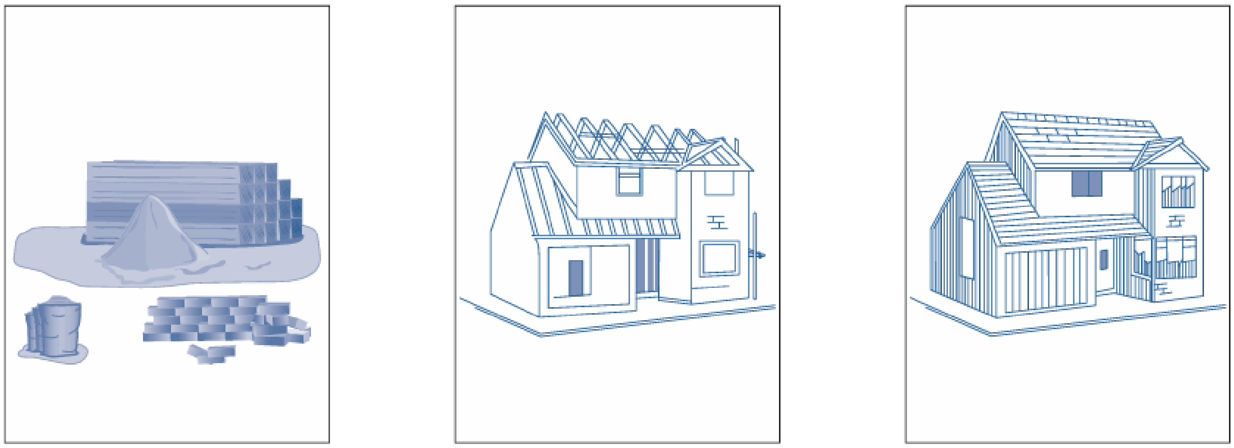


Figure 1.1 What businesses need

From the value created or added by the business, other costs have to be paid, such as labour and rent, so value created by a business is not the same as profit. However, if a business can create increased value without increasing its costs, then profit will increase.



Cost of input/materials Production process adds value Value of output of finished goods

Figure 1.2 Creating value by building a house from bought-in materials

Here are two examples of how different businesses could create added value to their products:

1. Jewellers – well-designed shop-window display, attractive shop fittings, well-dressed and knowledgeable shop assistants and beautiful boxes offered to customers to put new jewellery in.

2. Sweet manufacturer – extensive advertising of the brand of sweets to create an easily recognised name and brand identity, attractive packaging, selling through established confectionery shops and not 'cheap' vending machines

Economic activity and the problem of choice

In a world of wealth and scarcity, people face the economic problem of not being able to satisfy all their needs simultaneously. This leads to choices, as we must prioritize those we can currently satisfy and those we will forgo. This decision-making is not exclusive to consumers, but applies to all economic units, including governments, businesses, workers, and charities. The goal is to provide for as many wants as possible while still satisfying our needs.

If consumers choose to buy the smart phone, then the trainers become the opportunity cost

Opportunity cost

This needs to choose leads to the next important principle of our subject – opportunity cost.

KEY TERM

Opportunity cost: the benefit of the next most desired option which is given up.

or

The role of the entrepreneur

New business ventures started by **entrepreneurs** can be based on a totally new idea or a new way of offering a service

KEY TERM

Entrepreneur: someone who takes the financial risk of starting and managing a new venture.

Characteristics of successful entrepreneurs

Innovation: The entrepreneur may not be an inventor in the traditional sense, but they must be able to carve a new niche in the market, attract customers in innovative ways and present their business as being diff erent from others in the same market.

Commitment and self-motivation: It is never an easy option to set up and run your own business. It is hard work and may take up many hours of each day.

Multiskilled: An entrepreneur will have to make the product (or provide the service), promote it, sell it and keep accounts. These different business tasks require a person who has many different qualities.

Leadership skills: The entrepreneur will have to lead by example and must have a personality that encourages people in the business to follow them and be motivated by them.

Self-confidence and an ability to bounce back: Many business start-ups fail, yet this would not discourage a true entrepreneur who would have such belief in themselves and their business idea that they would bounce back from any setbacks.

Risk taking: Entrepreneurs must be willing to take risks in order to see results. Often the risk they take is by investing their own savings in the new business

Major challenges faced by entrepreneurs

Identifying successful business opportunities

Th e original idea for most new businesses comes from one of several sources including:

■ Own skills or hobbies – e.g. dressmaking or car bodywork repairing. Very often, these skills will enable an entrepreneur to off er them to friends and relatives and this could be the start of the business.

■ Previous employment experience – working for a successful hairdresser, for example, allows a potential entrepreneur to see the working of such a business and judge whether they could set up a similar business themselves.

■ Franchising conferences and exhibitions – these off er a wide range of new business start-up ideas, e.g. fast-food restaurants, which also give the potential benefits of the support of a much larger franchiser business.

■ Small-budget market research – the Internet allows any user to browse business directories to see how many businesses there are in the local area offering certain goods or services.

Sourcing capital (finance)

Once the entrepreneur has decided on the business idea or opportunity, the next task is to raise the necessary capital. So why is obtaining fi nance such a major problem for entrepreneurs?

■ Lack of sufficient own finance – many entrepreneurs have very limited personal savings, especially if they are setting up their own business because they were previously made redundant.

■ Lack of awareness of the financial support and grants available

■ Lack of any trading record to present to banks as evidence of past business success – a trading record would tend to give a bank confidence when deciding to lend money or not for a new venture.

■ A poorly produced business plan that fails to convince potential investors of the chances of a business's success.

Determining a location

Perhaps the most important consideration when choosing the location for a new business is the need to minimise fixed costs. When fi nance is limited, it is very important to try to keep the break-even level of output – the output level that earns enough revenue to cover all costs – as low as possible.

Th is has the great advantage of keeping costs low, but there are drawbacks:

■ It may not be close to the area with the biggest market potential.
■ It lacks stat us – a business with its own prestigious premises tends to generate confidence.
■ It may cause family tensions.
■ It may be difficult to separate private life from working life.

Competition

This is nearly always a problem for new enterprises unless the business idea is so unique that no other business has anything quite like it. A newly created business will often experience competition from older, established businesses, with more resources and more market knowledge.

Building a customer base

This is linked to the previous point about competition. To survive, a new firm must establish itself in the market and build up customer numbers as quickly as possible.

Many small businesses try to encourage this by offering a better service than their larger and better-funded competitors. Th is better service might include:

■ Personal customer service
■ Knowledgeable pre- and aft er-sales service
■ Providing for one-off customer requests that larger firms may be reluctant to provide for.

Why do new businesses often fail?

In fact, many businesses fail during their first year of operation. Th e most common reasons for new enterprises failing are:

Lack of record keeping

The lack of accurate records is a big reason for business failure. Many entrepreneurs fail to pay sufficient attention to this need as either they believe that it is less important than meeting their customers' needs, or they think they can remember everything.

How can the owner of a new, busy florist shop remember:

■ When the next delivery of fresh flowers is due?
■ Whether the flowers for last week's big wedding have been paid for?
■ If the cheque received from the government department for the display of flowers in its reception area has been paid into the bank yet?
■ How many hours the shop assistant worked last week?

Lack of cash and working capital

Serious working capital deficiencies can usually be avoided if several simple, but important, steps are taken as the business is being established:

■ Construct a cash flow forecast so that the liquidity and working capital needs of the business can be assessed month by month. Keep this updated and also show it to the bank manager.
■ Inject sufficient capital into the business at start-up to last for the first few months of operation when cash flow from customers may be slow to build up.
■ Establish good relations with the bank so that short-term problems may be, at least temporarily, overcome with an overdraft extension
■ Use effective credit control over customers' accounts – do not allow a period of credit that is too long, and regularly chase up late payers.

Poor management skills

Most entrepreneurs have had some form of work experience, but not necessarily at a management level. They may not have developed:

■ Leadership skills
■ Cash handling and cash management skills
■ Planning and coordinating skills
■ Decision-making skills
■ Communication skills
■ Marketing, promotion and selling skills.

Changes in the business environment

Setting up a new business is risky because the business environment is dynamic, or constantly changing. In addition to the problems and challenges referred to above, there is also the risk of change, which can make the original business idea much less successful.

It is enough to observe at this stage that new businesses may fail if any of the following changes occur, which may turn the venture from a successful one to a loss-making enterprise:

■ New competitors
■ Legal changes, e.g. outlawing the product altogether
■ Economic changes that leave customers with much less money to spend
■ Technological changes that make the methods used by the new business old-fashioned and expensive.

Common types of entrepreneurial businesses

New business start-ups can be found in nearly all industries, yet it is true to say that there are some industries and sectors of industry where there is a much greater likelihood of new entrepreneurs entering. These include:

Primary sector
- Fishing – e.g. a small boat owned by an entrepreneur
- Market gardening – producing cash crops to sell at local markets.

Secondary sector
- Jewellery-making
- Dressmaking
- Craft manufacture, e.g. batik cloth
- Building trades.

Tertiary/service sector
- Hairdressing
- Car repairs
- Cafés and restaurants
- Child-minding.

Impact of enterprise on a country's economy

All governments around the world are following policies that aim to encourage more people to become entrepreneurs.

Employment creation: In setting up a new business, an entrepreneur is employing not only themselves (self-employment), but also, very oft en, employing other people too. Very often these are members of the family or friends, but in creating such employment, the national level of unemployment will fall.

Economic growth: Any increase in output of goods or services from a start-up business will increase the gross domestic product of the country. This is called economic growth, and if enough small businesses are created, it will lead to increased living standards for the population.

Firms' survival and growth: Although a high proportion of new firms fail, some survive, and a few expand to become really important businesses. These will employ large numbers of workers, add considerably to economic growth and will take the place of declining businesses that may be forced to close due to changing consumer tastes or technology.

Innovation and technological change: New businesses tend to be innovative, and this creativity adds dynamism to an economy. This creativity can rub off on to other businesses and help to make the nation's business sector more competitive. Many new business start-ups are in the technology sector, e.g. website design.

Exports: Most business start-ups tend to off er goods and services that meet the needs of local or regional markets. Some will expand their operations to the export market, however, and this will increase the value of a nation's exports and improve its international competitiveness.

Personal development: Starting and managing a successful business can aid in the development of useful skills and help an individual towards self-actualization – a real sense of achievement.

Increased social cohesion: Unemployment often leads to serious social problems, and these can be much reduced if there is a successful and expanding small business sector

Social enterprise

Social enterprises are not charities, but they do have objectives that are often different from those of an entrepreneur who is only profit motivated.

KEY TERM

Social enterprise: a business with mainly social objectives that reinvests most of its profits into benefiting society rather than maximising returns to owners.

Social enterprises compete with other businesses in the same market or industry. They use business principles to achieve social objectives. Most social enterprises have these common features:

- They directly produce goods or provide services.
- They have social aims and use ethical ways of achieving them.
- They need to make a surplus or profit to survive as they cannot rely on donations as charities do.

Social enterprise – objectives
Social enterprises often have three main aims. These are:

KEY TERM

Triple bottom line: the three objectives of social enterprises: economic, social and environmental.

1. **Economic** – make a profit to reinvest back into the business and provide some return to owners

2. **Social** – provide jobs or support for local, often disadvantaged, communities

KEY TERM

Triple bottom line: the three objectives of social enterprises: economic, social and environmental.

3. **Environmental** – to protect the environment and to manage the business in an environmentally sustainable way.

These aims are often referred to as the triple bottom line. This means that profit is not the sole objective of these enterprises.

Revision questions

Q1. 9707/11/M/J/2012/Q1
(a) State two aims of a social enterprise organization. [2]
(b) Briefly explain how entrepreneurs could benefit your country. [3]

Q2. 9609/12/M/J/2016/Q1
(a) Define the term ‘entrepreneur’. [2]
(b) Briefly explain two reasons why new businesses often fail. [3]

Q3. 9609/13/M/J/2017/Q1
(a) Define the term ‘opportunity cost’. [2]
(b) Briefly explain how business decisions involve opportunity cost; using an appropriate example. [3]

Q4. 9609/12/O/N/2017/Q1
(a) Define the term enterprise. [2]
(b) Brief explain two aims of a social enterprise. [3]

Q5. 9609/12/F/M/2018/Q2
(a) Define the term 'entrepreneur'. [2]
(b) Briefly explain two qualities of a successful entrepreneur. [3]

Q6. 9707/13/M/J/2011/Q3
Explain why many businesses fail within the first year of trading. [5]

Q7. 9707/12/M/J/2012/Q3
Explain the main qualities of a successful entrepreneur. [5]

Q8. 9707/01/M/J/2009(a)
Discuss the problem a new business might experience in its first year of trading. [8]

Q9. 9609/13/O/N/2016/Q5 (a)
Analyses the qualities of a successful entrepreneur. [8]

Q10.9609/11/O/N/18/Q5 (a)
Analyses the qualities of a successful entrepreneur. [8]

Q11. 9609/12/M/J/2019/Q7 (a)
Analyses the impact of social enterprises on the development of a country. [8]

Q12. 9707/12/O/N/2014/Q7
(a) Explain the aims of a social enterprise organization. [8]
(b) Discuss the important of business enterprise in your country. [12]

Q13.9609/12/M/J/2017/Q5
(a) Analyses problems a business could experience in its first year of trading. [8]
(b) Discuss whether market research will reduce problems that might be experienced by a new start-up business. [12]

Q14.9609/13/M/J/2018/Q7
(a) Analyses the potential advantages to a community of a business with triple bottom line targets. [8]
(b) Discuss the role of business enterprise in the development of a country. [12]