Unit 01 – Business activity and influence on business

1.What is business activity?

Business Activity

A business is an organization that provides goods and services.

Features of a business activity:

1. Business activity produces and output.
2. Goods and services are consumed.
3. Resources are used.
4. A number of business functions may be carried out. (Production, Marketing, Human Resources and Financial controlls)
5. External factors affecting the business. (Government laws,Changes in consumers taste, Actions of the competitors)
6. Business aim to make a profit.

Good and services

Businesses provide a wide range of goods and services. Some are produced for consumers - ordinary people. These are called **consumer goods**. Products sold by one business to another are called **producer goods.**

Satisfying needs and wants

- Businesses have to satisfy people's **needs and wants.**
- Humans also have other desires. These are called wants and include holidays, a better house, a bigger car, a better education and a cleaner environment. These wants are **infinite**.
- Most people want more than they already have. It is human nature. Unfortunately, the resources available to businesses are **finite**.
- This means there is a limited amount. Economists say such resources are **scarce.**

Purpose of business activities

Different types of organization provide goods and services for different reasons. Each type of organization has different purpose:

1. **Private enterprises**

   Owned privately by individuals or a group of individuals. The objective of a private enterprise is often to make money- a profit for the owners.

2. **Social enterprises**

   Some organizations in the private sector are non- profit making. Organizations such as; charities, pressure groups, clubs and societies exist to raise money for good causes.

3. Public enterprises

Some goods and services are provided by organizations owned by central and local government. They often provide health care, Education, Mail delivery, Policing, Fire services and Environmental services.

Business stake holders

Any individual or group that that has an interest in the operation of a business is called a "stakeholder

Owners

A business belongs to its owners. Many small businesses are owned by individuals, families or small group of people. These people are often called "entrepreneur".

Customers

Customers buy the goods and services that businesses sell.

Employees

Employees work for businesses. They depend on businesses for their salaries.

Managers

Managers help to run most businesses. They are mostly employed to run different departments in the business such as marketing, production, finance and human resources. They are accountable to the owners.

Financiers

Financiers lend money to a business. They may be banks but could be individuals, such as family members, or a private investor such as venture capitalist.

The changing business environment

All business operates in a changing business environment. This means that they may be affected by external factors that are likely to change overtime. Such factors include the strength of competition, the economic climate, government legislation, population trends, demand patterns, world affairs and social factors.

1.2 Business objectives

The importance of clear objectives

Business needs to have objectives for the following reason:

- Employees need something to work towards
- Without objectives owners might not have the motivation needed to keep the business going
- Objectives help to decide where to take a business and what steps are necessary to get there.

It is easier to assess the performance of a business if objectives are set.

Financial objectives

The main financial objectives are:

- Survival
- Profit
- Sales
- Increase market share
- Financial security

Non financial objectives

These are the objectives that are not connected with money. Whether owners have such objectives often depends on the nature of the business. Some business owners might have both financial and non-financial objectives.

- Social objectives
- Personal satisfaction
- Challenge
- Independence and Control

PERSONAL SATISFACTION

Many business owners set up a business because they think they will be happier and feel more satisfied in their work environment than when working for an employer. Such owners are likely to enjoy taking risk and seeing their idea succeed. Some owners have developed their hobby into a business.

CHALLENGE

Some people are motivated by challenges and starting a business can be very challenging. To be successful in businesspeople need to be committed, hardworking and multi-skilled.

INDEPENDENCE AND CONTROL

Some people want to be 'their own boss' - they want to be in control. This is an important non-financial objective for many business owners. These entrepreneurs are driven by the desire to be independent and to take control of their own futures. The freedom to make all the decisions when running a business is very appealing. Some people often dislike being told what to do at work.

Why might objectives change as business evolve?

1. **Market conditions**
   Businesses operate in dynamic markets. This means they have to deal with regular changes.

2. **Technology**
   As the pace of technological development increases business may have to adjust their objectives.

3. **Performance**
   The performances of business are not likely to stay constant. Periods of sustained profitability maybe interrupted by less successful periods. The performance rate of a business may have an impact on their objectives.

4. **Legislation**
   new legislations might have an impact on the objectives of a business.

5. **Internal reasons**
   The reasons outlined above a business changing its objective are mainly owing to external factors. However, sometimes a business might change its objectives for internal reasons.

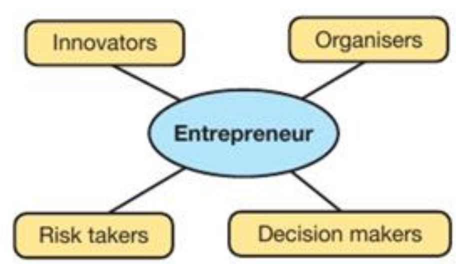
1.3 Sole traders, Partnerships, Social enterprises and franchises

Entrepreneur

People who set up businesses are called Entrepreneur.

The roles played by an entrepreneur:

- Innovators
- Organizers
- Risk takers
- Decision makers



▲ Figure 3.1 Roles of the entrepreneur

Unincorporated and Incorporated business

1. **Unincorporated**
   Businesses where there is no legal difference between the owner and the business

2. **Incorporated**
   Business that has a separate legal identity from that of its owners

Features of a sole trader

A **sole trader or sole proprietor** is the simplest form of business organisation. It has one owner but can employ any number of people. Sole traders may be involved in a wide range of business activity.

ADVANTAGES OF A SOLE TRADER	DISADVANTAGES OF A SOLE TRADER
The owner keeps all the profit.	Have unlimited liability.
They are independent – owner has complete control.	May struggle to raise finance – considered too risky by those that lend money.
It is simple to set up with no legal requirements.	Independence may be too much of a responsibility.
Flexibility – for example, can adapt to change quickly.	Long hours and very hard work.
Can offer a personal service because they are small.	Usually too small to exploit economies of scale.
May qualify for government help.	No continuity – the business dies with the owner.

Features of a Partnership

- Partnership
  Business owned by beteween 2 and 20 people. They also share the profit. Professions such a accountants, doctors, estate agents and solicitors are often partnerships.
- Deed of partnership
- Binding legal documents that states the formal rights of partners.

ADVANTAGES OF PARTNERSHIPS	DISADVANTAGES OF PARTNERSHIPS
Easy to set up and run – no legal formalities.	Partners have unlimited liability.
Partners can specialise in their area of expertise.	Profit has to be shared.
The job of running a business is shared.	Partners may disagree and fall out.
More capital can be raised with more owners.	Any partners' decision is legally binding on all.
Financial information is not published.	Partnerships still tend to be small.

Limited partnership

Limited partnership- partnership where someone partners contribute capital and enjoy a share of the profit but do not take part in the running of the business

Limited liability- business owner is only liable for the original amount of money invested in the business.

Audits- official examination of company's financial records in order to check that they are correct.

Features of a franchise

what does the franchisor offer franchisee?

- A license to trade under the recognized brand name of the franchisor.
- A start-up package including help, advice and essential equipment, usually including branding materials.
- Training in how to run the business and operate the systems used by the franchise.
- Materials, equipment and support services that are needed to run the business. Marketing support that is organized on behalf of all franchisees.
- An exclusive geographical area in which to operate. This means that the business will not face competition from other franchisees in the same franchise group.

In return the franchises have to pay certain fees

- A one-off start-up fee.
- An ongoing fee (usually based on sales).
- Contribution to marketing costs.
- Franchisors may make a profit on some of the materials, equipment and merchandise supplied to franchisees.

ADVANTAGES TO THE FRANCHISEE	DISADVANTAGES TO THE FRANCHISEE	ADVANTAGES TO THE FRANCHISOR	DISADVANTAGES TO THE FRANCHISOR
Less risk – a tried and tested idea is used. Back-up support is given. Set-up costs are predictable. National marketing may be organised.	Profit is shared with the franchisor. Strict contracts have to be signed. Lack of independence – strict operating rules apply. Can be an expensive way to start a business.	Fast method of growth. Cheaper method of growth. Franchisees take some of the risk. Franchisees more motivated than employees.	Potential profit is shared with franchisee. Poor franchisees may damage brand's reputation. Franchisees may get merchandise from elsewhere. Cost of support for franchisees may be high.

Features of social enterprises

Generally social enterprises have:

- Have a clear social and / or environmental mission
- Generate most of their income through trade or donations
- Reinvest most of the profits
- Are majority controlled in the interest of the social mission
- Are accountable and transparent

Social enterprises may take a variety of forms,

- **Cooperative**
  Usually operates as consumer cooperative or retail cooperative. They are owned and controlled by their members. Any profit made is given to members.

- **Worker cooperative**
  Are businesses in which its employees share ownership. Workers will contribute to production and be involved in decision making, share in the profit and provide some capital when buying a share in the business.

- **Charities**
  Exists to raise money for good causes and draw attention to the needs of disadvantaged group of society. They rely on donations for their revenue.

1.4 Limited companies and partnerships

Features of limited companies

Limited companies are incorporate. This means that they have a separate legal identity from their owner.

The other main features are:

- The owners have limited liabilities.
  If a limited company has debts, the owners can only lose the memory the originally invested.

- The business raise capital by selling shares
  Each holder owns a number of these shares. They are the joint owners of the company.

- The shareholders elect directors to run the company.
  The board of directors, headed by the chairperson, is accountable to shareholders.

- Whereas sole traders and partnerships pay income tax, companies pay corporation tax on profits.

- To form a limited company, it is necessary to follow a legal procedure.

Forming a limited company

A limited company must have a minimum of two members, but there is no upper limit. Some important documents must be sent to the registrar of companies before a limited company can be formed. The two most important documents are: Memorandum of Association and Articles of Association. If these documents are acceptable, the company will get a certificate of incorporation

Private limited companies

Most private limited companies tend to be small or medium sized.

Some features of private limited companies are:

- Their business name ends in limited or LTD.

- Shares can only be transferred 'privately'. Shares on private limited cannot be traded on share market.

- They are often family businesses owned by family members or close friends.

- The directors of these firms tends to be shareholders and are involved in the running of the business.

ADVANTAGES OF PRIVATE LIMITED COMPANIES	DISADVANTAGES OF PRIVATE LIMITED COMPANIES
Shareholders have limited liability.	Financial information has to be made public.
More capital can be raised.	Costs money and takes time to set up.
Control cannot be lost to outsiders.	Profits are shared between more members.
Business continues if a shareholder dies.	Takes time to transfer shares to new owner.
Has more status – for example, than a sole trader.	Cannot raise huge amounts of money, like PLCs.

Public limited companies

Public limited companies (PLC) tend to be larger than private limited companies. Their shares can be bought and sold by the public on stock exchange.

‘Going public’ can be expensive because:

- The company needs lawyers to ensure that the prospectus is legally correct.
- The prospectus has to be printed and circulated.
- A bank maybe paid to process share applications.
- The company must insure against the possibility of some shares remaining unsold; therefore, a fee is paid to an underwriter who must by any unsold shares.
- There are advertising and administrative expenses.
- The PLC must have a minimum of £50 000 share capital.

ADVANTAGES OF PUBLIC LIMITED COMPANIES	DISADVANTAGES OF PUBLIC LIMITED COMPANIES
Large amounts of capital can be raised.	Setting up costs can be very expensive.
Shareholders have limited liability.	Outsiders can take control by buying shares.
PLCs can exploit economies of scale.	More financial information has to be made public.
May be able to dominate the market.	May be more remote from customers.
Shares can be bought and sold very easily.	More regulatory control owing to Company Acts.
May have a very high profile in the media.	Managers may take control rather than owners.

Features of multinationals

Multinational company is a large business with significant production or service operations in at least two different countries. Some of the key features are:

- Huge assets and turnovers
- High qualified and experienced professional executives and managers
- Powerful advertising and marketing capabilities
- High advanced and up-to-date technology
- Highly influential both economically and politically
- Very efficient since they can exploit huge economies of scale
- Ownership and control is centered in the host country

1.5 Public operations

Features of public corporations

- **State owned**
  The government owns public corporations. The government is responsible for the corporation’s policies.

- **Created by law**
  Public corporations are created by an act of parliament.

- **Incorporation**
  This means they have a separate legal identity. They can sue, be sued and enter into contracts under their own name.

- **State funded**
  The government provides the capital needed by public corporation. The money mainly comes from tax.

- **Provide public services**
  Their main objective is to provide a public service. Profit is not usually the driving force behind public corporations.

- **Public accountability**
  They have to produce annual reports, which are submitted to the government minister in charge of the particular corporation. Ultimately, they are accountable to taxpayers because state- owned corporations are accountable to the public. If a public corporation makes a profit, the money will either be reinvested in the business or handed over to the government.

Reasons for the public ownership of businesses

- Avoid wasteful duplications
  It would be a waste of resources if, for example, two or more water companies built their own system of pipes to distribute water to all households in an area.

- Maintain control of strategic industries
  If the provision of a particular service is vital to the well-being of the nation, it is considered desirable for the government to maintain control so that a reliable supply and quality can be guaranteed.

- Save jobs
  In some cases, businesses have been taken into public ownership to save jobs. A government might take control of a failing private sector business if it employs very large numbers of people. It might be preferable to allow a business to carry on trading even though it is losing money if it prevents mass unemployment.

- Fill the gaps left by the private sector
  For example, it is desirable that everyone gets an education because it benefits society as a whole.

- Serve unprofitable regions
  For example, the cost of providing electricity to a remote farm many miles away from the main power lines would be too high for a private sector operator. However, a public corporation may be prepared to meet this cost because profit is not a key objective.

Reasons against the public ownership of business

- Cost of government
  A number of public corporations make losses. These losses have to be met by the taxpayer. If losses get bigger, and more frequent, taxpayers might object to the financial burden. Also, any money used to subsidise public corporations cannot be used for more attractive alternatives, such as improving international security.

- Inefficiency
  The cause of such inefficiency is often blamed on a lack of competition, the absence of profit as an objective and the knowledge that they cannot 'go bust' because losses will be met by the government.

- Political interference
  Public corporations often suffer owing to government interference. This may occur because different governments have different views about the way public corporations should operate. As a result, corporations are subject to policy changes every time a new government is elected.

- Difficult to control

  Some public corporations are very large. This may employ many thousands of workers spread across a wide geographical area and own huge quantities of physical assets. This might make it difficult to coordinate different parts of the business and run it efficiently

Privatization

Privatization can take a number of forms:

1. Sale of public corporation
   The sale of public corporations has been a popular way of transferring business activity from the public to the private sector. One way of doing this is to sell shares in the business to anyone that wants them. In some cases, governments have sold off parts state-owned business over a period of time.

2. Deregulation
   This involves lifting legal restrictions that prevented private sector competition.

3. Contracting out
   Many government and local authority services have been 'contracted out' to private sector business.

4. The sale of land and property

Why does privatization take place?

1. To generate income
2. To reduce inefficiency in the public sector
3. As a result of deregulation
4. To prevent political interference

1.6 Appropriateness of different forms of ownership

Factors affecting the appropriateness of different forms of ownership

- Growth
  Many business start small and gradually get bigger. Most business change their legal status as they grow. This is because they need to raise more capital.

- Size
  Many small businesses are sole traders or partnerships. Public limited companies are much larger with thousands of employees and huge turnovers.

- The need for finance
  Finance is one of the main reasons why owners change the legal state of their own business. Quite often the only way to get more money is to get more money is to change the type organization.

- Control
  Some owners like their independence. They like to have the complete control of their business. This is why many owners remain as solo traders. Once new partners or shareholders join the business, some control is lost because it is shared with the new partners or owners. It is possible to keep control of a limited company by holding the majority of shares. However, even if one person holds 51 percent of shares in a limited company, the wishes of the holders of the other 49 percent cannot be ignored.

- Limited liability
  Owners can protect their own personal financial position if the business is a limited company. Sole traders and partners have unlimited liabilities. Because of this they could be forced to to use their own money to meet business debt.

Other factors

- The type of business activity may influence the choice of legal status.
- The way in which a business plans to use its profits may be important.
- The different stakeholders such as the employees and shareholders might influence the choice of organization.

Objectives and the type of organizations

- Small sole traders might be happy to make a modest amount of profit, just enough to fund a comfortable lifestyle. They may not want the responsibility associated with other objectives such as growth. This is sometimes called “profit satisfaction”.

- Family business and other medium- sized private limited companies often do not wish to go public because they are afraid of losing control to outsiders. As a result, their growth might be limited and other objectives are more important.

- Most multinationals want to grow. Their aim is often to get bigger and bigger so that they can dominate world market.

1.7 Classification of business

Primary sector

- Agriculture
  Involves a range of farming activities. Probably the most important primary sector activity in most of the countries.

- Fishing
  Involves netting, trapping, angling and trawling for fish. It also includes catching or gathering other types of seafood such as mussels, prawns, lobsters, crabs, scallops and oysters. China is the world's largest fish producer.

- Forestry
  Involves managing forest to provide Timber or wood production. Modern forestry also involves protecting the natural environment.

- Mining and quarrying
  Is the extraction of raw materials such as coal, iron ore, copper, tin, salt and limestone from the ground? This sector also includes the extraction of oil and gas. Saudi Aramco, the largest oil producers in the world.

Secondary sector

Secondary sector business activities include metalworking, car production, textile production, chemical and engineering industries, aerospace manufacturing, energy utilities, engineering, food processing, construction and shipbuilding.

Some businesses focus on the production of semi- finished goods.These goods are sold to other businesses and used as input for the production of final goods which are then sold to consumers.

Tertiary sector

- Commercial services
  Freight delivery, debt collection, printing and employment agencies.

- Financial services
  Banking, insurance, investment advice and pensions.

- Household services
  Plumbing, decorating, gardening and household maintenance.

- Leisure services
  Television, tourism, hotels and liabilities.

- Professional services
  Accountancy, legal advice, medical care.

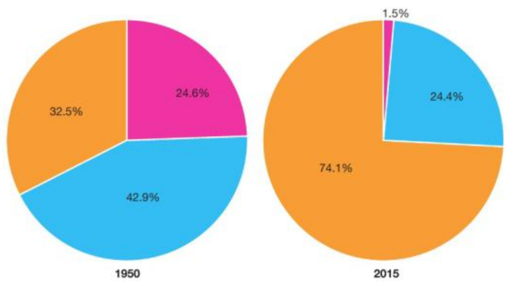
- Transport
  Train, bus, taxi, air services.

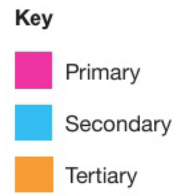
Interdependence

Business in each of the three sectors above are likely to be independent. This means they rely on each other.

Changes in sectors

The number of people employed in each sector does not stay the same. Different sectors grow and decline overtime.





1.8 Decision on location

Factors influencing the location and relocation of businesses

Historically, many manufacturers were located near to the sources of power and raw materials. Steel and chemical heavy industries were located close to power sources, such as coal, and raw materials, such as water and iron ore. The steel industry was successful in the Ruhr and Rhine valleys in Germany because all these resources were available in the locality. Today, electricity and gas can be supplied to most places, therefore manufacturers may not have to be located close to power sources.

Proximity to market, labour, materials and competitors

Proximity to the market

- Businesses that make large or heavy products may be located close to their customers to keep transport costs down.
- he manufacturers of parts often locate close to their customers where components are assembled into final products. Many service providers have to locate their premises close to their markets.

Proximity to the labour

Businesses needing large numbers of workers have to consider wage costs and labour skills. Wage rates may vary in different regions and large companies may also consider locating in countries where labour is very cheap. Also, labour skills are not evenly distributed throughout a country. If a firm needs a particular type of skilled labour, certain locations may be more suitable than others.

Proximity to the Materials

- Businesses that use large amounts of raw materials that are difficult to transport may choose to locate their premises very close to their sources.

- Some businesses, such as large supermarkets and manufacturers, require large areas of land to locate buildings, staff car parks and other facilities. As a result, they look to minimise land and property costs.

Proximity to the Competitors

Most service providers will prefer to locate where competition is minimised. For example, an entrepreneur opening a hair and beauty salon may avoid locations where such businesses already exist. However, in contrast, some business deliberately chooses locations where competitors are closely concentrated.

The nature of business activity

- **Services**

Increasingly, when choosing a suitable location, businesses have to take into account the ease of access and parking facilities. Traffic congestion is a growing problem in many parts of the world and businesses need to choose locations where there is less chance of delays. It is particularly important for customers since they will try to find alternatives if they cannot park conveniently.

- Office based businesses

In some fields of business, such as creative marketing, consultancy, financial services and customer service provision, business activity is office based. If large numbers of people have to be employed in offices, businesses may need to ensure that there are sufficient facilities such as restaurants, cafés and hotels, nearby.

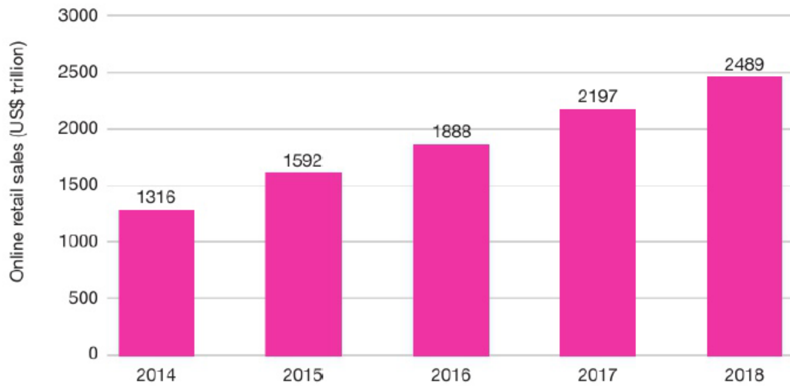
The locations chosen by manufacturers may vary. This is because different types of manufacturing have different needs. For example, manufacturing that is labour intensive will need to locate where there is a good supply of skilled and relatively cheap labour.

- Agriculture

Most farmers require large areas of land for their businesses. However, not all land is the same and some farming activity needs a particular type of land. For example, dairy farmers need land where grass can grow effectively so that cows can get access to a good food source.

The Impact of the internet on location decisions

Many people are switching to the Internet when shopping rather than going to stores. There has been a huge growth in e-commerce, which has had a massive impact on business locations.



Influence of legal controls and trade blocs on location

- Legal Controls

- To avoid congestion where there is already enough or too much development.
- Minimise the impact businesses might have on local communities.
- To encourage manufacturers to locate where unemployment is high.
- Government often use financial incentives to influence business choice of location.

- Trade blockers

Many countries use trade barriers to control the level of imports into their country. There are a number of reasons for this, which are discussed in Chapter 13. These trade barriers can have an impact on location decisions for businesses. To avoid trade barriers, such as tariffs

1.9 Globalization

The concept for globalization

Many of today's markets are global. This means that some firms expect to sell their products anywhere in the world. Some of the key features of globalisation are outlined below.

■Goods and services are traded freely across international borders. There are no government laws to prevent firms from selling goods in overseas markets.

■People are free to live and work in any country they choose.

■There is a high level of interdependence between nations. This means that events in one economy are likely to affect other economies.

■Capital can flow freely between different countries. This means that a firm or consumer in Australia can put their savings in a bank in the USA. This also means that investors can buy shares in foreign companies and firms can buy companies that operate in other countries.

■There is a free exchange of technology and **intellectual property** across borders.

Reasons for globalization

There is a general agreement that modern globalisation began in the 1980s and has grown rapidly. There are a number of reasons for this trend.

■Developments in technology have helped globalisation to gather pace. Modern computing allows firms to transfer complex data instantly to any part of the world. It also means that more people can work at home, or any other location that they choose.

■International transport networks have improved in recent years. In particular, the cost of flying has fallen and the number of flights and destinations flown to has increased.

■There has been a huge amount of deregulation. Privatisation has allowed more competition in many industries. Also, a lot of the barriers to trade have been removed. An increasing number of economies are more open, and more and more countries have stopped protecting domestic industries.

■An increase in tourism has also helped globalisation to thrive. Consumer tastes have changed as a result of their experiences when travelling abroad. People are more willing to try goods and services produced in other countries.

■Many firms want to sell abroad, perhaps because domestic markets have become saturated. Some markets are dominated by large multinationals, which have a global outlook.

Government and globalization

Globalisation can only flourish if governments are committed to it.

Opportunities of globalization for business

The common view is that globalisation has a range of benefits. However, there are some specific opportunities opened up by globalisation that many businesses may be able to exploit.

ACCESS TO LARGER MARKETS

One of the most important benefits to business of globalisation is access to huge markets. Clearly global markets are considerably larger than domestic markets. If a business has access to several billion customers rather than, say, 40 million, this provides huge opportunities to increase sales.

LOWER COSTS

If businesses are able to grow by selling more output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale. These are the cost reductions that firms can enjoy as they grow.

ACCESS TO LABOUR

One of the benefits of globalisation is the free movement of labour. As a result businesses will have access to a larger pool of labour. This is important for a number of reasons.

■If a business is growing fast there may be a shortage of domestic labour. Globalisation means that workers from overseas can help to boost the labour supply.

■A rising labour supply might help to prevent wages from rising. It is often said that the arrival of larger numbers of foreign workers hold wages down - particularly in markets where unskilled labour is needed. Lower wages will help businesses to lower their costs.

■Globalisation means that businesses can recruit highly skilled staff from anywhere in the world. In some countries there are skills gaps, which means that there is a shortage of workers with specific skills.

REDUCED TAXATION

One benefit of globalisation is that businesses can choose where to locate their base. Consequently, they can reduce the amount of tax they pay by locating their head office in a country where business taxes are low.

Threats of globalization to business

Despite the benefits and opportunities that increasing globalisation brings to a business, there are a number of threats that they might have to deal with. Some examples are outlined below.

COMPETITION

Businesses will face increased competition as a result of globalisation. As more companies around the world try to sell their goods and services in an increasing number of countries, some businesses will have their survival threatened.

INTERNATIONAL TAKEOVERS

With the free movement of capital that globalisation brings, it is possible for a business in one country to take over a business in another. Consequently, companies may feel more vulnerable to a takeover since there are a larger number of predator businesses. Some experience a hostile takeover, when a company is taken over against its will.

INCREASED RISK OF EXTERNAL SHOCKS

The interdependence that results from globalisation could pose a threat to businesses. This means that events in one economy are likely to affect other economies.

1.10 The importance and growth of multinational business

Multinationals contribute about 10 per cent to world GDP and about 66 per cent to global exports. They have a significant and increasing role in the world economy.

How have multinationals developed?

ECONOMIES OF SCALE

Many companies have developed into multinationals because larger companies enjoy lower costs. This is because they can exploit economies of scale.

MARKETING

Some firms have become multinationals by relying on effective marketing. Firms such as Starbucks and McDonald's are good examples. These are low- tech firms that have developed a successful brand at home and then exploited it globally. Both companies face fierce competition in their markets.

TECHNICAL AND FINANCIAL SUPERIORITY

Most multinationals have developed into large businesses over a period of time, enjoying superiority. They have developed advanced technologies and built a huge bank of knowledge. They can also afford to invest heavily in research and development.

Benefits to a business of becoming multinational

Owing to their size, multinational companies generally enjoy higher revenues and lower costs. Some of the specific benefits of becoming a multinational are outlined below.

LARGER CUSTOMER BASE

Multinationals will have access to a much wider market than companies that focus entirely on domestic markets. Multinationals can boost their sales revenues by selling to global markets. This will help to increase profits and win market share from competitors.

LOWER COSTS

Since multinationals are large companies, they can exploit economies of scale and enjoy lower costs. They can buy resources at lower prices and borrow money at cheaper rates,

HIGHER PROFILE

If a business is able to develop as a multinational it will enjoy a higher profile in the market. Large companies with strong brand names are recognisable and may become household names. This helps to encourage existing customers and attract new ones.

AVOIDING TRADE BARRIERS

One of the benefits of becoming a multinational is that trade barriers can be avoided. Since multinationals are prepared to set up operations in other countries, they can bypass trade barriers by establishing operations in those countries that have barriers in place.

LOWER TAXES

Multinationals can reduce the amount of tax they pay on their profits by basing their head offices in countries where taxes are lower.

Benefits of multinational to a country/economy

INCREASE IN INCOME AND EMPLOYMENT

When multinationals set up operations overseas, income in those countries rises. Multinationals create new jobs in developing countries.

INCREASE IN TAX REVENUE

The profits made by multinationals are taxed by the host nation. This increases tax revenue for the government in that country and this can be used to improve government services.

INCREASE IN EXPORTS

The output produced by a multinational in a particular country is recorded as output for that country. Therefore, if this output is sold out of the host country, it is counted as an export. This helps countries to increase their foreign currency reserves.

TRANSFER OF TECHNOLOGY

Multinationals often provide foreign suppliers with technical help, training and other information. They may also help local suppliers to purchase resources and modernize production facilities.

IMPROVEMENT IN THE QUALITY OF HUMAN CAPITAL

Multinationals provide training and work experience for their workers. In less developed countries such training may otherwise be unavailable.

ENTERPRISE DEVELOPMENT

The arrival of multinationals has encouraged more people to set up businesses in less developed countries. Multinationals may have provided the skills and motivation needed for enterprise.

Possible drawbacks of multinationals to a country / economy

ENVIRONMENTAL DAMAGE

Many environmentalists are suspicious of multinationals because they may cause environmental damage. One reason is because multinationals are heavily involved in the extraction industries, such as coal, oil and gold mining. Mining is often destructive.

EXPLOITATION OF LESS DEVELOPED COUNTRIES

It is sometimes argued that multinationals bring exploitation to developing nations.

■ Some multinationals may encourage developing countries to rely on producing primary products. This is risky because the prices of primary products can change sharply, which causes variations in income.

■ Multinationals often pay low wages. They may also employ child labour and the working conditions in their factories are often very poor.

■ Taxes paid to the host nation are often minimal.

■ As little as possible is put back into the country because this would reduce the amount of profit made by the multinational.

REPATRIATION OF PROFITS

The profits made by multinationals abroad are often repatriated. This means that profits are returned to the country where the multinational is based and has its headquarters.

LACK OF ACCOUNTABILITY

Some argue that because multinationals are so large and powerful they lack accountability. This means they may be able to evade the law, especially in countries where the government is weak or corrupt. Also, multinationals may be keener to operate where regulation is insufficient or non-existent.

1.11 International trade and union trades

International trade

International trade benefits the world. It creates opportunities for business growth, increases competition and provides more consumer choice. Specifically international trade:

■Allows countries to obtain goods that cannot be produced domestically

■Allows countries to obtain goods that can be bought more cheaply from overseas

■Helps to improve consumer choice

■Provides opportunities for countries to sell off **surplus** commodities.

Visible and invisible trade

Goods and services sold overseas are called **exports**. Those bought from other countries are called **imports**. A distinction is made between **visible trade** and **invisible trade**. Visible trade involves trade in physical goods.

What is an exchange rate?

Most countries in the world do not use the same currency. When countries use different currencies, **transactions** between people and firms in different countries are affected.

How many dollars could the visitor get for 20000 rupees? This depends on the **exchange rate** between the rupee and the dollar.

The impact of changes in the exchange rate on importers and exporters

FALL IN THE EXCHANGE RATE

■**Impact on exports**: If a UK firm sells goods worth £2 million to a US customer, the dollar price at the original exchange rate is US$3 million (£2 million x US$1.50). When the exchange rate falls, the dollar price of the goods also falls to US$2.4 million (£2 million x US$1.20). This means that demand for UK exports is likely to rise because they are now cheaper than they were before the change in exchange rate.

■**Impact on imports**: If another UK firm buys goods worth US$600 000 from a US supplier, the price in pounds at the original exchange rate is £400000 (US$600000 ÷ US$1.50). When the exchange rate falls, the sterling price to the importer rises to £500000 (US$600 000 US$1.20). This means that demand for imports is likely to fall because they are dearer

RISE IN THE EXCHANGE RATE

■**Impact on exports**: If a UK firm sells goods worth £2 million to a US customer, the dollar price at the original exchange rate is US$3 million (£2 million x US$1.50). When the exchange rises, the dollar price of the goods also rises to US$4 million (£2 million x US$2.00). This means that demand for UK exports is likely to fall because they are now dearer.

■**Impact on imports**: If another UK firm buys goods worth US$600 000 from a US supplier, the price in pounds at the original exchange rate is £400000 (US$600000 US$1.50). When the exchange rate rises, the sterling price to the importer falls to £300000 (US$600000+ US$2.00). This means that demand for imports is likely to rise because they are cheaper.

International competitiveness and exchange rate

Exchange rates can impact a country's international competitiveness and the prices of imports and exports. Rising exchange rates can benefit businesses by increasing demand for exports and decreasing import prices

1.12 Government objectives and policies

Government spending

One of the roles of most governments is to provide a range of public services. These might include health care, education, defence, care for the elderly, child protection, policing, refuse collection, a judicial system and transport networks. The amount of money spent by governments on these services will vary enormously.

Taxation

Taxes, such as income and corporation taxes, are levied on personal income and profits, while indirect taxes like Value Added Tax (VAT) are levied on spending. **Fiscal policy** influences economic demand and businesses.

Constraints on public spending

In recent years, some governments have tried to constrain levels of public spending. One reason for this was because some countries built up massive debts as a result of the financial crisis in 2008. The effects on businesses of such constraints can be severe. Some explains given below.

■Public sector organisations that supply services directly may get their funding cut.

■Private sector businesses that rely on public sector contracts for part, or all, of their business will be hit.

■Cuts in pensions and other government payments. In some countries, government payments, such as pensions and social security payments have been frozen or cut.

How can government affect business activity

The government can affect business activity in a number of ways. It can:

■Change the law

■Influence the rate of interest and exchange rates in the economy change levels of government expenditure and taxation

■Introduce polices that have a direct impact on businesses such as giving subsidies to farmers.

Three specific approaches are outlined below.

INFRASTRUCTURE PROVISION

The Ugandan government prioritized infrastructure investment in 2015, planning a 10-year $11,000 million spending program to upgrade transport networks and increase electricity capacity. This heavy expenditure benefits businesses, particularly construction companies and their suppliers. The government's money can boost demand for all types of businesses.

LEGISLATION

Without government intervention, some businesses may not meet the needs of certain stakeholders. Some might go further and exploit vulnerable stakeholders. One of the roles of the government is to provide a legal framework in which businesses can operate and ensure that vulnerable groups are protected. Three areas where legislation has a particular impact on businesses are outlined below.

Consumer protection

Consumers want to buy good quality products at a fair price and receive good customer service. They want information about products that is accurate and clear. Without government regulation, some firms may exploit consumers by using **anti-competitive practices** or **restrictive practices**.

▶ Figure 12.4 Consumer issues covered by legislation

Competition policy

Governments should try to promote competition. This helps to prevent anti- competitive practices and consumer exploitation. How might they do this?

■Encourage the growth of small firms: If more small firms are encouraged to join markets there will be more competition. With more small firms the market is less likely to be dominated by one very large firm.

■Introduce anti-competitive legislation: Many countries have laws that help to encourage competition. Such laws are often designed to protect consumers from exploitation by monopolies, mergers and restrictive practices.

Environmental legislation

■Business activity can have a negative impact on the environment.

TRADE POLICY

Despite the benefits of international trade, governments sometimes believe that it is in the nation's interests to restrict trade. This is called **protectionism** and might be used to:

■protect jobs if foreign competitors threaten the survival of domestic producers

■protect **infant industries** (new industries that are yet to get established)

■prevent **dumping** (where foreign producers sell goods below cost in a domestic market)

■raise revenue from tariffs.

Governments can use **trade barriers** to restrict trade.

■Tariffs: a tax on imports, which makes them more expensive.

■Quota: a physical limit on the amount allowed into the country.

■Subsidy: the giving of financial support, such as grants or tax breaks, to exporters or domestic producers that face fierce competition from imports.

■ **Administrative barriers**: the use of strict health and safety or environmental regulations and specifications to make importing more awkward.

The main benefits to businesses of trade blocs include:

■The opportunity to specialise in the production of those goods and services which they can produce more expertly or at a lower cost

■Access to wider markets

■Lower costs, if economies of scale can be exploited when sales and output rise

■Protection from large predatory multinationals from outside the bloc.

Effects of interest rates on business

Interest is the cost of borrowing money and the reward to savers. **Interest** rates are usually controlled by the authorities and can therefore change. The use of interest rates to help control the economy is called **monetary policy.**

Generally high interest rates are bad for businesses for the following reasons.

■When the interest rate rises, costs will increase for any business that has already taken out a loan. The majority of businesses have loans, mortgages or overdrafts to help fund their activities..

■The purchase of capital goods funded by borrowing is discouraged because it is more expensive. This means that businesses will be reluctant to invest in new machinery, equipment and research and development. If businesses postpone or cancel investment, they may fail to keep up with changes in technology.

■Higher interest rates usually mean that demand in the economy falls. This is because consumers are less willing to borrow money to fund spending. This will clearly have an impact on businesses.

Effects of interest rates on consumer spending

Changes in the interest rate can have a significant effect on consumer behaviour. Generally higher interest rates are bad for consumers BUT not all of them.

■House-owners with mortgages will be affected negatively when interest rates rise. This is because most people's mortgage payments rise. As a result, they will have less disposable income (income remaining after taxes and bills are paid for) to spend. Obviously, people with larger mortgages will be hit harder than those with smaller ones.

■Demand for goods bought with borrowed money will fall when interest rates rise. Many people use loans, overdrafts and credit cards to fund their spending.

■Savers will be hit if interest rates are low. This is because they will earn less interest on their savings. Consequently, consumers that rely heavily on income from savings, such as the retired community, will have less to spend.

1.13 External factors

The nature of external factors

External factors can unexpectedly impact businesses, causing changes in operations. For instance, the 2014 oil price drop had both positive and negative effects. Oil industry companies experienced revenue drops and reduced exploration activities, while transport companies, like delivery contractors, saw significant fuel cost reductions, boosting profits.

Social

Businesses have to adapt to any changes that occur in society. Some examples of changes that have occurred in recent years are outlined below.

■**Increased consumer awareness**: Consumers have higher expectations than ever before. They have easy access through the Internet to lots of information about products and are more aware of their rights.

■**Changing demand patterns**: Changes in society bring about changes in demand for products.

■**Increased numbers of women at work**: In many countries, more and more women have abandoned the traditional childcare role and have combined family life with employment and running businesses.

■**More part-time workers**: In many countries there has been a huge increase in the number of people taking on part-time work. This has helped to improve flexibility in business organisations because part-time labour is more adaptive.

■ **Urbanisatio**n: In some countries, such as Brazil, India and China, very large numbers of people have left rural areas to live in towns and cities. This has provided businesses with more labour and created additional markets to which goods and services can be supplied.

Technology

■In the primary sector, the use of tractors, mechanical harvesters, grain- drying machines and automatic feeding systems have helped to lower costs in agriculture. Chemicals and pesticides have also helped to increase crop yields.

■In the secondary sector, the introduction of robots on production lines has reduced costs. They are cheaper to employ than people because they can work 24/7.

■The use of technology in service industries has reduced costs.

■The use of IT has helped to reduce administration and communication costs in business.

The rate of technological change seems to increase all the time. Businesses usually welcome technological developments because they often provide new product opportunities or help to improve efficiency.

■Changes in technology can shorten the amount of time products can be marketed for. This is because new products are quickly developed to replace ones that use old technology.

■Developments in technology often mean that businesses can replace labour with capital. This is welcomed because human resources are often said to be the most difficult to manage. New technology also lowers unit costs.

■The development of social media has helped to improve communications between businesses and customers. This allows businesses to remain aware of changing consumer needs.

Environment

Evidence suggests that as economies grow environmental damage increases. Businesses are often blamed for pollution and congestion. Some examples of other environmental issues are outlined below.

GLOBAL WARMING

Many governments are becoming increasingly concerned about global warming, which may be affecting weather patterns and climates. Some of the greenhouse gases, such as carbon dioxide, which contribute to global warming, come from factories.

HABITAT DESTRUCTION

Some business development destroys wildlife habitats and spoils the natural environment.

RESOURCE DEPLETION

In addition to the loss of forests, many other resources are at risk of running out.

■ Oil, coal, gas and minerals are non-renewable resources and, therefore, cannot be replaced. Because of this, as business development gathers pace, these resources are depleted.

■Fish stocks are falling. The world's marine catch increased from 18.5 million tonnes in 1950 to 82.5 million tonnes in 1992. This huge growth is threatening millions of people who depend on fishing for their livelihoods.

■Fertile soil, which is needed to grow food, is being lost. The loss is caused by deforestation, poor farming practices, over-grazing, the increasing size of urban areas and land pollution.

SUSTAINABLE DEVELOPMENT

Many governments are promoting the idea of sustainable development. This means that people should satisfy their needs and enjoy better living standards without doing so in ways that will reduce the quality of life of future generations. Business development that denies future generations of resources is not sustainable. Businesses may respond to environmental issues in several ways.

Businesses may respond to environmental issues in several ways. For example, to help reduce resource depletion businesses could:

■Design packaging that can be reused or recycled

■Use more energy-efficient equipment or renewable energy sources

■ Explore ways of selling waste to other businesses as a by-product

■Reduce business travel and use video conferencing for meetings.

Political

Some parts of the world are politically unstable. Businesses need to be cautious if they develop interests in such countries.

■In 2015, some felt that Greece might leave the EU. This could have disrupted financial markets and created a great deal of uncertainty in the Eurozone.

■In 2016, the UK voted to leave the EU. Not many people would have predicted this and the effects of Brexit, as it became called, are still to be determined.

■The issue of national security has become a priority for many governments.If measures designed to improve national security restrict the movement of goods, people and capital, this could have a negative impact on businesses.

■ Pressure groups, such as ASH, which aims to eliminate the harm done by smoking, can affect businesses

■ A new government might be elected which is very pro-business. This might encourage more people to become entrepreneurs. It might also mean that more foreign investment may be attracted.

1.14 Measuring success in business

Measure of successes

The success of a business can be measured in different ways. Several approaches are outlined below.

REVENUE

The amount of revenue generated by a business is a guide to its success. If revenues increase each year, most business owners would feel that they were making a success of their venture. In 'Getting started' above, DiGi's revenue rose from MYR 5954 million to MYR 6914 million over five years. This is an increase of 16.1 per cent. Whether this can be regarded as a success depends on DiGi's sales objectives, trading conditions over the time period and the revenues received by rivals in the industry.

MARKET SHARE

Businesses aim to increase their market share annually to dominate the market and raise their profile. However, measuring market share can be challenging due to the need for information about market size and supplier revenues, which may be difficult to obtain. Therefore, using market share value to measure success may be challenging.

CUSTOMER SATISFACTION

A successful business relies on customer satisfaction, which is measured by the satisfaction of consumers' needs and wants. Businesses are becoming customer-focused, monitoring complaints and taking complaints seriously.

PROFIT

Most private sector businesses aim to make a profit. Therefore, rising profits should signal improving success. However, a number of factors have to be taken into account.

■It is possible to make higher profits if there is no competition in the market. Therefore, profits made by a monopoly are not as impressive as profits made in a competitive market.

■The amount of profit made by a business will often depend on its size.

■Profit should also be compared with that made by other businesses in the same industry. This will provide a better measure of success because different industries often expect different profit levels.

■Profit can only be used to measure success if the objective of the business is to maximise profit.

GROWTH

Many businesses aim to grow, therefore the size of the business is important when measuring success. However, there are several different ways of measuring size. The main ones are listed below.

■Turnover or revenue: The revenue of a business could be used to measure size.

■The number of employees: A business with thousands of employees may be considered large.

■Market share: It could be argued that a business with a 43 per cent market share is more successful than one that has a 9 per cent market share in the same industry.

■The amount of capital employed: Capital employed is the amount of money invested in a business. The more money invested the larger the business.

■EU definitions of size: The EU defines the size of firms according to turnover, the number of employees and the **capital employed**.

OWNER/SHAREHOLDER SATISFACTION

Shareholders in public limited companies focus on dividend payments and share prices to judge a business's success. Large financial institutions, such as insurance providers, pension funds, and investment companies, are focused on short-term returns and regular dividend growth. BMW, a German car maker, has seen a 39% increase in dividends per share and share price over the past decade, but may be disappointed that the price was not sustained.

EMPLOYEE SATISFACTION

Employees in a business have unique needs compared to shareholders or owners. They rely on businesses for their livelihood and want the business to be successful. They want higher wages, benefits, and job security. However, they also need training, good working conditions, fair treatment, promotion opportunities, safety, and equal opportunities. If a business can satisfy these needs, it is considered successful. However, profitability may not always mean success from an employee's perspective, as redundant workers may not see the business as successful.

The importance of targets when judging successes

Setting objectives (targets) in business management helps measure success, motivate staff, and adjust to current circumstances. For instance, a business might set a 5% market share growth target, aiming for a 6.5% increase by the end of the year.

1.15. Reasons for business failure

Business failure

The global business failure rate is high, with 58% of new businesses failing within four years in the UK and 470,000 in the USA in 2015. Common reasons include financial constraints, lack of funding, and insufficient funding. Effective financial planning is crucial for entrepreneurs to ensure they have sufficient funds when needed.

Cash flow problems

Many businesses fail because they run out of cash. Some entrepreneurs focus too much on profit and forget about the importance of cash. There are a number of reasons why a business runs short of cash.

OVERTRADING

Young and rapidly growing businesses are particularly at risk of overtrading. This occurs when a business is attempting to fund a large volume of production with insufficient cash. This can happen even if a business is profitable. The problem is that cash runs out while it is spending money on resources to meet a rising number of orders.

INVESTING TOO MUCH IN FIXED ASSETS

When businesses first start trading, funds are limited. Spending large amounts initially on equipment, vehicles and other capital items can quickly use up resources. It may be better to lease some of these **fixed assets** to protect cash reserves.

ALLOWING TOO MUCH CREDIT

A great deal of business relies on credit. This means that goods are sold and the customer pays for them at a later date - perhaps after 3 months.

OVER-BORROWING

Businesses may borrow to finance growth. As more loans are taken out, interest costs rise. To avoid over borrowing, a business may try to raise more capital from the owners - perhaps by selling shares.

SEASONAL FACTORS

Sometimes trade varies for seasonal reasons. In agriculture, cereal farmers have a large cash inflow when their harvest is sold. For much of the year, though, they have to pay expenses without any cash flowing in. This situation requires careful management, although it is possible to predict these changes.

UNEXPECTED EXPENDITURE

Businesses need to be prepared for any unforeseen expenditure. In the early stages of business development, owners are often hit by unforeseen expenditure. This might be caused by lack of experience or poor planning.

EXTERNAL FACTORS

Sometimes events that are outside the control of the business cause cash flow problems.

POOR FINANCIAL MANAGEMENT

Inexperience in managing cash or a poor understanding of the way cash flows into and out of a business may lead to cash flow problems.

Lack of finance

New businesses often struggle to attract funding because they do not have a trading history and, again, they are too risky for investors. Some business owners think they can survive with limited amounts of capital by being cautious. This means they might be **undercapitalised.**

Not competitive

Some businesses fail because they are unable to compete effectively in the market. There could be a number of reasons why businesses eventually lose out to their rivals.

NEW ENTRANTS

A business may begin successfully and then fail because a new rival enters the market and takes away their trade. Many small businesses collapse because they are 'overrun' by larger competitors in the market. Competitors might:

■bring out superior products - for example, the mobile phone maker Nokia failed because Apple and Android came along with better products

■read market conditions more effectively - for example, some businesses fail because they bring out products that are unpopular in the market

■charge lower prices because their costs are lower- for example, in recent years many manufacturers in the West have been **outcompeted** by low-cost producers from China and other emerging nations where labour costs are lower

■ use 'destroyer pricing' (very high discounting), if they are a powerful company, to drive smaller rivals out of the market - this might happen when a company 'dumps' a cheap product in a foreign market.

INEFFECTIVE COST CONTROL

In some cases, businesses cannot keep their costs down. If costs are too high, then a business needs to charge more to make a profit. This might result in a loss of trade to low-cost competitors. A firm's costs might be higher than rivals for a number of reasons.

■They may be too small to exploit economies of scale. Larger rivals that produce much more output enjoy lower unit costs - perhaps because they can buy enormous quantities of raw materials at lower prices.

■They may be wasteful.

■It is possible that a business is paying too much for some of its resources. It may not be spending enough time researching suppliers in the market.

■In some circumstances, a business might not be minimising labour costs.

■Costs might also rise owing to external factors.

INEFFECTIVE MARKETING

Businesses may struggle to compete if their marketing is weak. Below are some examples.

■A business might launch a new product, which fails to take off.

■A business might use inappropriate pricing strategies, which could mean that prices are too high or too low. If prices are too high, customers will switch to a rival. If they are too low, customers might think that the quality of the product is poor.

■A business might invest too heavily in overpriced or inappropriate marketing campaigns. Some businesses invest huge amounts of money in advertising and promotion, and it does not always pay off.

■A business might use an inappropriate marketing strategy.

LACK OF BUSINESS SKILLS

Some businesses lack competitiveness and fail because their owners are not sufficiently skilled. Running a business is challenging and requires many skills. Entrepreneurs have to be creative, good with numbers, motivational and good decision makers.

POOR LEADERSHIP

There have been cases where senior managers and business leaders have brought bring down companies by their actions. A business might lose its competitive edge in the market because the leader makes a mistake. This could be the result of poor decision making or a failure to make urgent changes.

Failure to innovate

Some businesses collapse because they fail to innovate - they do not change with the times. They may have failed to adopt new technology or to develop new products. Some are not prepared to take the risk and invest money - they are too cautious. As a result, they lose out to their more innovative rivals.