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Excerpt
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The graphic features a dark blue background with a white rectangular area containing the text. The text 'Unit 1' is in a large, outlined font, and 'Business and its environment' is in a bold, solid dark blue font.

Unit 1

Business and its environment

1

Enterprise

This chapter covers syllabus section 1AS.1.

On completing this chapter, you will be able to:

- understand what business activity involves
- analyse the meaning and importance of value added
- recognise the key characteristics of successful entrepreneurs
- assess the importance of enterprise and entrepreneurs to a country's economy
- understand the meaning of social enterprise and the difference between this and other businesses.

Introducing the topic

Dulip starts his business

Dulip lives in a large country with many natural resources, such as coal and timber. He plans to start a business growing and cutting trees to sell as timber. He wants to buy a forest from a farmer and cut down a fixed number of trees each year. As Dulip is concerned about the environment of his country, he will plant two new trees for each one he cuts down. He has been planning this business venture for some time. He has visited a bank to arrange a loan. He has contacted suppliers of saws and other equipment to check on prices. Dulip also visited several furniture companies to see if they would be interested in buying wood from the forest. In fact, he did a great deal of planning before he was able to start his business.

Dulip is prepared to take risks and will invest his own savings, as well as using the bank loan, to set up the business. He plans to employ three workers to help him to start with. If the business is a success, then he will also try to sell some of the timber abroad. He knows that timber prices are high in some foreign markets. After several months of planning, he was able to purchase the forest.

Points to think about:

- Why do you think Dulip decided to own and run his own business rather than work for another firm?
- Why was it important to Dulip that he should do so much planning before starting his business?
- Do you think Dulip will make a successful entrepreneur?
- Are new businesses such as Dulip's good for the economy of a country? Give reasons for your answer.

Introduction

Many business managers are paid high salaries to take risks and make decisions that will influence the future success of their business. Much of this book is concerned with how these decisions are made, the information needed to make them and the techniques that can assist managers in this important task. However, no student of Business Studies can hope to make much progress in the study of this subject unless they have a good understanding of the economic environment in which a business operates. Business activity does not take place in isolation from what is going on around it. The very structure and health of the economy will have a great impact on how successful business activity is. The central purpose of this whole unit, ‘Business and its environment’, is to introduce the inter-relationships between businesses, the world in which they operate and the limits that governments impose on business activity. This 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 any organisation that uses resources to meet the needs of customers by providing a product or service that they demand. There are several stages in the production of finished goods. Business activity at all stages involves adding value to resources, such as raw materials and semi-finished goods, and making them more desirable to – and thus valued by – the final purchaser of them. Without business activity, we would all still be entirely dependent on the goods that we could make or grow ourselves – as some people in virtually undiscovered native communities still are. Business activity uses the scarce resources of our planet to produce goods and services that allow us all to enjoy a very much higher standard of living than would be possible if we remained entirely self-sufficient.

What do businesses do?

Businesses identify the needs of consumers or other firms. They then purchase resources – or factors of production – in order to produce goods and services that satisfy these needs, usually with the aim of making a profit. Before we go on, it will be useful

to explain some important business terms that have either already been used, or will be referred to soon, in this chapter. 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 DEFINITIONS

- 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
- capital goods** the physical goods used by industry to aid in the production of other goods and services, such as machines and commercial vehicles

What do businesses need to produce goods and services?

Factors of production

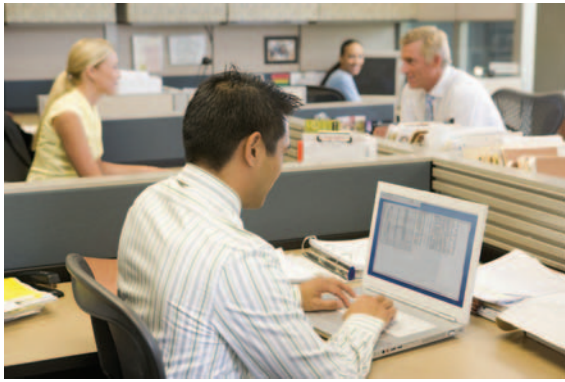
These are the resources needed by business to produce goods or services. They include:

- **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, offices 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.

Businesses have many other needs before they can successfully produce the goods and services demanded by customers. Figure 1.1 shows the wide range of these needs.



Timber is a natural resource



All businesses need labour



Capital equipment can be very complex

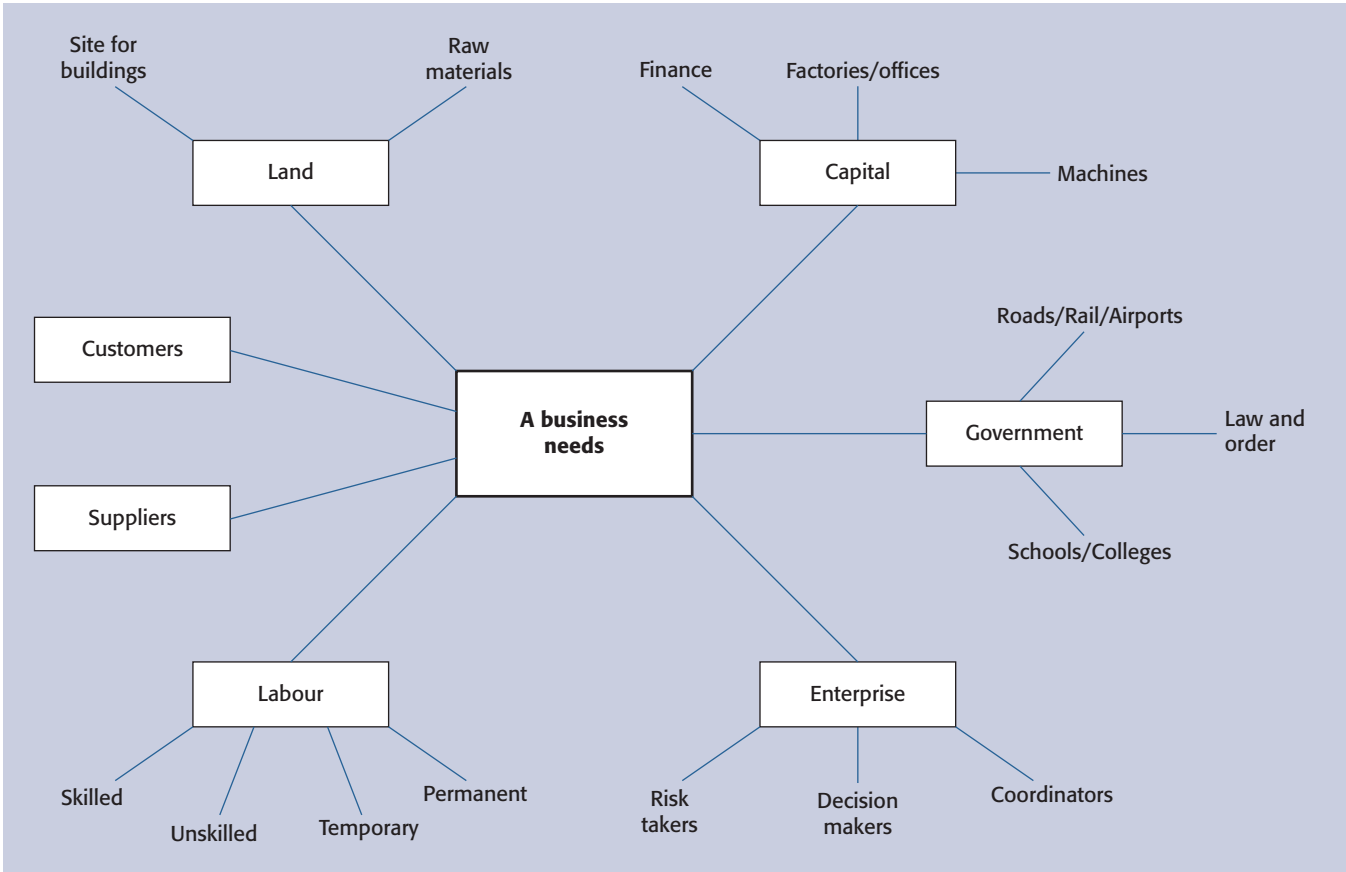


Figure 1.1 What businesses need

The concept of adding value (added value)

A business adds value to the raw materials it uses to produce the good or service it sells. Added value is one of the key objectives of any business. If a customer is prepared to pay a price that is much greater than the cost of materials used in making or providing a good or service, then the business has been successful in ‘adding value’.

KEY DEFINITION

added value the difference between the cost of purchasing raw materials and the price the finished goods are sold for

The concept of value added can be illustrated by an example taken from the building industry (see also Figure 1.2).

From the value added by the business, other costs have to be paid, such as labour and rent – value added is *not* the same as profit. However, if a business can increase its value added without increasing its costs, then profit *will* increase. Here are two examples of how different businesses could add value to their products, but they do increase costs:

- 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.

Activity 1.1

[AS/A level – 12 marks, 25 minutes]
How could the following businesses add value to the goods they buy in:

- hotel
- car dealer
- clothing manufacturer
- fast-food restaurant?

The role of the entrepreneur

KEY DEFINITION

entrepreneur someone who takes the financial risk of starting and managing a new venture

New business ventures started by entrepreneurs can be based on a totally new idea or a new way of offering a service. They can also be a new location for an existing

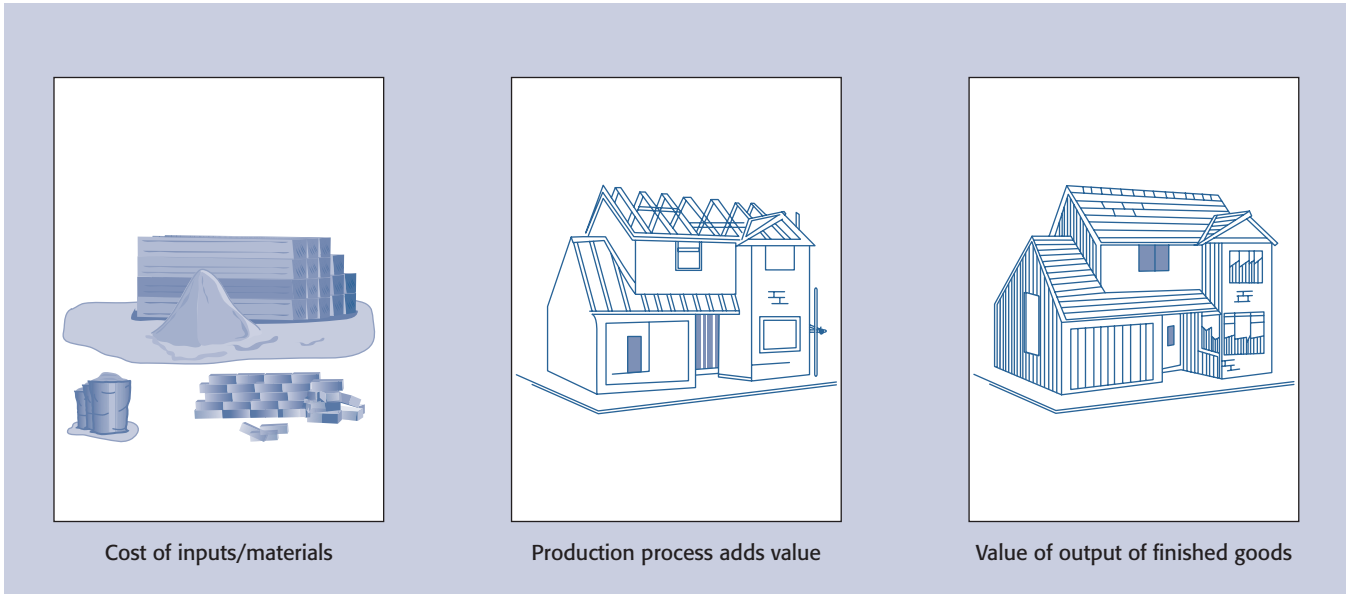


Figure 1.2 Value added

business idea or an attempt to adapt a good or service in ways that no one else has tried before. In this chapter, we will be looking at several examples of people who have set up their own new business and have shown skills of ‘entrepreneurship’. They have:

- had an idea for a new business
- invested some of their own savings and capital
- accepted the responsibility of managing the business
- accepted the possible risks of failure.

Characteristics of successful entrepreneurs

The personal qualities and skills needed to make a success of a new business venture include:

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 consumers in innovative ways and present their business as being ‘different’ from others in the same market. This requires original ideas and an ability to do things differently – this is the skill of innovation.

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. A willingness to work hard, keen ambition to succeed, energy and focus are all essential qualities of a successful entrepreneur.

Multi-skilled An entrepreneur will have to make the product (or provide the service), promote it, sell it and count the money. These different business tasks require a person who has many different qualities, such as being keen to learn technical skills, able to get on with people and good at handling money and keeping accounting records.

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

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 self-belief in themselves and their business idea that he or she 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.

Activity 1.2

Read the case study below and then tackle the exercises that follow.

Bangalore enterprise blossoms

Rama Karaturi gained the idea for his rose-growing business when he searched, without success, for a bouquet of roses for his wife in Bangalore. The city was a rose-free zone, so he decided to start growing them himself. In 1996, he opened two greenhouses growing just roses. He used his own savings, so took a considerable risk, but his confidence in the growth of ‘flower giving’ at times of major festivals encouraged other investors too. He sold the flowers in India, but his business also became one of the first in India to start exporting flowers on a large scale. Rama worked long hours to make his business a success. The business, called Katuri Networks, has grown at a tremendous rate, helped by Rama’s all-round business skills. He recently bought out a large rose grower in Kenya and his business is now the world’s largest cultivator of roses – and Rama achieved this in a little over ten years.

Source: business.timesonline/article2733212 (adapted).

[AS/A level – 10 marks, 15 minutes]

- 1 Rama is an example of a ‘business entrepreneur’. Explain what is meant by this term. [4]
- 2 Outline any **three** characteristics of Rama’s personality that led to the success of his enterprise. [6]

Major challenges faced by entrepreneurs

Identifying successful business opportunities

Identifying successful business opportunities is one of the most important stages in being an effective entrepreneur. Many people say that they ‘want to work for themselves’, but they do not make the leap into entrepreneurship successfully because they have not been able to identify a **market need** that will offer sufficient demand for their product to allow the business to be profitable. The original idea for most

new businesses comes from one of several sources including:

- Own skills or hobbies – e.g. dress making or car bodywork repairing. Very often, these skills will enable an entrepreneur to offer 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 offer 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 use of 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. Such small-scale research might indicate ‘gaps’ in local markets that could be profitably filled by the entrepreneur.

Sourcing capital (finance)

Once the entrepreneur has decided on the business idea or opportunity, the next task is to raise the necessary capital. In an International Labour Organisation survey of new business start-ups, the problem of finance came top of the list of replies from entrepreneurs regarding the main difficulty. The sources of financial support offered to micro business start-ups are explained in Chapter 26. Why is obtaining finance 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 finance 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. This will greatly increase the chances of survival. Operating from home is the most common way for entrepreneurs to establish their business. This 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 status – 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.



The cost and position of these locations could have a big impact on the business entrepreneur's chance of success

New businesses that offer a consumer service need to consider location very carefully. Whereas a website designer could operate from home very effectively, as communication with customers will be by electronic means, a hairdresser may need to consider obtaining

premises in an area with the biggest number of potential customers. An alternative is to visit customers in their own homes – this way, the entrepreneur may avoid the costs of buying or renting their own premises altogether.

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. The entrepreneur may have to offer a better customer service to overcome the cost and pricing advantages that bigger businesses can usually offer.

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. The long-term strength of the business will depend on encouraging customers to return to purchase products

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

- personal customer service
- knowledgeable pre- and after-sales service
- providing for one-off customer requests that larger firms may be reluctant to provide for.

Why do new businesses often fail?

Even if an entrepreneur has all of the qualities listed above, success with a new business can never be **guaranteed**. In fact, many businesses fail during their first year of operation. The 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. The latter will be



Activity 1.3

Read the case study below and then tackle the exercises that follow.

Farah branches out on her own

Farah was a well-qualified dressmaker. She had worked for two of the biggest dress shops in town. She was always arguing with her shop manager, who was very jealous about Farah’s superior dress-making skills. Farah was now determined to set up her own business. She was lucky that her father was prepared to invest \$5,000 in it, but she would have to find the rest of the capital needed – about \$10,000, she guessed – from her own savings and a bank loan. Her first step was to investigate the prices of shop premises and she was disappointed when she found out how expensive the city-centre locations were. Her father suggested a cheaper but less busy out-of-town location. She contacted an accountant who offered to look after the financial side of the business, but he would charge at least \$2,000 per year. Farah wondered if she could learn to keep the accounts herself if she attended classes at the local college in the evening. She wanted to make her shop very

different from all of the competitors in the city and she had the idea of offering lessons in dress making as well as selling finished dresses. She had been asked so many times by customers, ‘How did you do that?’ when they were pleased with her latest dress designs, that she was sure this was a great business opportunity. What she had not realised was the amount of paperwork she had to complete before her business could even start trading.

[AS/A level – 22 marks, 25 minutes]

- 1 Outline **three** problems that Farah had to deal with in setting up this new business. [6]
- 2 Which of these problems do you think was the most important one for Farah to find a good solution to? Explain your answer. [6]
- 3 Do you think Farah had some of the right qualities to be a successful entrepreneur? Justify your answer. [10]

quite impossible after a period of time. 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?

There are many other examples that could be given to illustrate the crucial importance of keeping accurate and up-to-date records of business transactions and other matters.

With the falling cost of computing power, most businesses, even newly formed ones, keep records on computer. It is always advisable to keep paper records too – when these exist – for example, receipts from suppliers or details of big deliveries. Not only can these act as a check or back-up system if the computer should fail, but they can also provide evidence to, say, the tax authorities if they dispute the entrepreneur's own tax calculations.

Lack of working capital

Running short of capital to run day-to-day business affairs is the single most common reason for the failure of new businesses to survive the first year of operation.

Capital is needed for day-to-day cash, for the holding of stocks and to allow the giving of trade credit to customers, who then become debtors. Without sufficient working capital, the business may be unable to buy more stocks or pay suppliers or offer credit to important customers. All of these factors could lead to the business closing down.

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 gained experience of:

- leadership skills
- cash handling and cash management skills
- planning and coordinating skills
- decision-making skills
- communication skills
- marketing, promotion and selling skills.

They may be very keen, willing to work hard and have undoubted abilities in their chosen field, e.g. an entrepreneur opening a restaurant may be an excellent chef, but management skills may be lacking. Some learn these skills very quickly once the business is up and running, but this is quite a risky strategy. Some organisations exist to provide support for new entrepreneurs in the form of advice and training. Some entrepreneurs 'buy in' experience by employing staff with management experience, but how many newly formed businesses can afford this expensive option?

It is wrong to think, just because a business is new and small, that enthusiasm, a strong personality and hard work will be sufficient to ensure success. This may prove to be the case, but often it is not. So potential entrepreneurs are usually encouraged to attend training courses to gain some of these skills before putting their hard-earned capital at risk or to first seek management experience through employment.

Changes in the business environment

Setting up a new business is risky. Not only are there the problems and challenges referred to above, but there is also the risk of change, which can make the original business idea much less successful. Change is a key feature of Business Studies syllabuses and, therefore, of this book – indeed there is a whole section on change