Section 1: UNDERSTANDING BUSINESS ACTIVITY
Business activity

1.01 Needs and wants

Needs are things that we must have to survive such as shelter, clothing and food. Wants are things that we would like to have to make our lives more enjoyable. People can live without satisfying their wants, but not without meeting their needs.

1.02 Scarcity and opportunity cost

Scarcity of resources creates a basic economic problem. Resources are limited but people's wants are not. Choices must be made. Resources used to make one thing cannot be used for another purpose. The value of the option not selected is known as the opportunity cost.

Worked example

Business A is a retailer. Next to the shop the business owns a large plot of land. The business can either use the space to extend the shop or turn it into a customer car park. It decides to extend the shop. The opportunity cost is the car park.

1.03 Importance of specialisation

Most production involves more than one person or piece of equipment. People and businesses specialise, to try not to waste limited resources. This can involve division of labour where workers are given a specific job to do. This should lead to:

- less wastage of scarce resources
- lower production costs
- greater output from same amount of resources.

TERMS

Opportunity cost: the cost of something in terms of the next best option.

Scarcity: limited availability of resources to meet the unlimited wants of people.

1.04 The purpose of business activity

All businesses use factors of production to make goods or provide services, in order to satisfy people's needs and wants.

These factors of production can be classified into four main groups:

<table>
<thead>
<tr>
<th>Type of factor</th>
<th>Description of factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Land</td>
<td>includes all natural resources as well as the space used for production</td>
</tr>
<tr>
<td>Labour</td>
<td>the workers</td>
</tr>
<tr>
<td>Capital</td>
<td>the finance, machinery and buildings used to produce goods and services</td>
</tr>
<tr>
<td>Enterprise</td>
<td>the people who organise the land, labour and capital</td>
</tr>
</tbody>
</table>

Table 1.01 The four factors of production.
Ways for a business to increase added value include:

- make raw materials into finished goods
- branding
- packaging
- add extra features to products
- improve customer service.

**TERM**

**Added value:** the difference between the selling price of a product and the cost of raw materials used to make it.

**Sample question**

Jian owns a restaurant in the city centre. His menu changes daily, depending on what meat and vegetables are available. All ingredients are bought locally which helps to keep costs low. Jian is always trying to increase added value.

Identify and explain two ways that Jian could increase added value. [6]

**Sample answer:**

**Way 1:** Jian can buy in the meat and vegetables at low cost and turn them into finished dishes for the customers, so there is a greater difference between the cost to make the dishes and price charged for them. [3]

**Way 2:** Provide a good customer service to customers in the restaurant. This adds to the experience, so customers are willing to pay more for a meal rather than go to cheaper places. [3]

**TIP**

Always look at the context. Suitable options will vary with the type of product. Use the context to improve your answer. Remember: for application, you must link the point to the scenario.

**TIP**

Simply using the name of the business is not classed as application.

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**Figure 1.01 Summary chart: added value at Tickers.**

<table>
<thead>
<tr>
<th>Cost of bought-in materials</th>
<th>Profit</th>
<th>Labour and other costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>$150</td>
<td>$25</td>
<td>$75</td>
</tr>
<tr>
<td>$50</td>
<td>$75</td>
<td></td>
</tr>
</tbody>
</table>

**TIP**

Capital has many meanings in business. Make sure you understand what it refers to in a given situation.

**TIP**

A business can be one person, a large global company employing thousands of people or even a charity.
Section 1: Understanding business activity

Sample questions

Example 1:
What is meant by ‘factor of production’? [2]

Sample answer:
The things needed to make goods and services such as land and labour. [1]

Example 2:
TGA is a leading manufacturer of mobile phones. Identify and explain two ways in which TGA could increase added value. [4]

Sample answer:
Way 1: add new features such as better camera zoom. [1]
Way 2: create a strong brand image so that people are willing to pay more for its phones. [1]

Summary
This unit covers a number of basic ideas. The fact that resources are limited means that businesses have to decide how best to use the factors of production. Specialisation can help. A business will try to add value at every stage of production as this can help make a profit.

Progress check
1 What is meant by scarcity?
2 What is the difference between a need and a want? Give an example of each.
3 Explain what is the main purpose of business activity.
4 State two factors of production for a market trader.

Examination-style questions

NSN makes a range of luxury cars. People like its handmade seats and car warranty. This is a competitive market. The Finance Director knows that resources are scarce, and he must use factors of production carefully. He believes that for every decision he makes, there will be an opportunity cost. The Finance Director is looking for ways to increase added value.

a What is meant by ‘opportunity cost’? [2]

b Identify two factors of production. Factor 1: Factor 2: [2]

c Identify and explain two benefits to NSN of increasing added value. Benefit 1: Benefit 2: [4]

d Identify and explain two ways that NSN could increase added value. Way 1: Way 2: [8]
Classification of businesses

Learning summary
By the end of this unit you should understand:

- the difference between primary, secondary and tertiary sectors
- reasons for the changing importance of business classification
- the difference between the private sector and public sector.

2.01 Classification of business

Businesses are grouped into three main types of business activity (sectors):

Primary sector
This involves the extraction, growing or collecting of raw materials. Examples include mining, farming and fishing.

Secondary sector
This includes any business involved in assembly, processing or construction. Businesses will either make a finished product or make parts for another business to use. Examples include manufacturing and refining.

Tertiary sector
Other businesses need to use services such as transport, retailing, warehousing and finance to get products to consumers. Examples of services for individuals include health care, education and restaurants.

<table>
<thead>
<tr>
<th>Name of sector</th>
<th>Primary</th>
<th>Secondary</th>
<th>Tertiary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main activity</td>
<td>Extract</td>
<td>Make</td>
<td>Service</td>
</tr>
<tr>
<td>Example</td>
<td>Cotton farmer</td>
<td>Clothing factory</td>
<td>Transport company or retailer</td>
</tr>
</tbody>
</table>

Table 2.01 Summary of the three sectors.

All three sectors are linked together. If any part of the chain breaks down, the customer will not get the finished products.

TERMS

Primary sector: businesses that extract or collect raw materials.

Secondary sector: businesses that take raw materials and turn them into finished goods.

Tertiary sector: businesses that provide services to other businesses and individuals.

Sample question
PVN is a printing business in the secondary sector. What is meant by 'secondary sector'? [2]

Sample answer:
It is where things are made. For example, PVN will take wood pulp and use it to make paper.

TIP
You do not need to use a textbook definition as long as you can clearly explain what the term means.

Some businesses can be involved in more than one stage of production.
2.02 The changing importance of business classification

The size of each sector varies between different countries. It can also change over time. Reasons for this include:

- Deindustrialisation – there is a decline in manufacturing while the tertiary sector increases.
- Raw materials are discovered/depleted in different countries.
- Specialisation – some countries are good at making certain products or services.
- Some countries have large workforces so can make products at a lower cost.
- Rising living standards – people have more time and money for leisure activities.

Sample question

The employment minister in country C has been looking at some employment data, as shown in Figure 2.01. He said, ‘We used to be a country known for growing sugar. Now it’s all hotels and shops. What has happened?’

Sample answer:

Change 1: Fall in primary sector by 20%. People may have moved to tertiary sector in search of higher wages. [3]

Change 2: Fall in secondary sector by 15%. This could be due to the fact that some goods can be made cheaper in other countries. [3]

TIP

If you are asked to interpret charts or tables, use the numbers to support your answer.

2.03 The public and private sectors

Most countries have both a public sector and private sector: this is called a mixed economy. Examples of public sector organisations include health care, education, defence, public transport and energy. Sole traders and limited companies are examples of private sector businesses (see 4.01 and 4.04).

TIP

All public and private sector organisations are involved in some form of business activity – it is only the objectives (what, for whom and why they produce goods and services) that differ.

TERMS

Public sector: any business owned, run or controlled by the government.

Private sector: any business owned, run or controlled by private individuals.

Public corporation: a business organisation owned and controlled by the government.
2 Classification of businesses

Sample question

Example:
Post Now is a private limited company. It is a letter delivery service in the private sector. Its main competitor, MPO, is in the public sector.

Identify and explain two differences between the two businesses. [6]

Sample answer:
Difference 1: Post Now is owned by individuals [1] who bought shares in the private limited company [1], while MPO is owned by the government. [1]

Difference 2: Post Now’s objective is to make profit [1] from delivering letters [1] while MPO’s priority will be to provide a service. [1]

Summary

Businesses can be grouped into three sectors. The importance of each sector for an economy can change. Goods and services can be provided by either public or private sector businesses.

Progress check

1 In which sector would you find a public corporation?
2 Give two examples of a secondary sector business.
3 Using a ring as an example of a product, show the link between the three sectors.
4 What is the difference between public and private sector businesses?

Examination-style questions

Question 1

Ravel is a farmer in country A. He has been looking at some data, shown in Table 2.02. He cannot understand why there is a difference in employment between countries. Both countries have a mixed economy.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Country A</th>
<th>Country B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary sector</td>
<td>45</td>
<td>10</td>
</tr>
<tr>
<td>Secondary sector</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>Tertiary</td>
<td>35</td>
<td>70</td>
</tr>
</tbody>
</table>

Table 2.02 Percentage of labour force employed in each country.

NOTE: Population of each country is 60 million.

a Identify one type of business that could be found in the:

b Calculate the number of people employed in the tertiary sector in country A. [2]

c Identify and explain two possible reasons for the difference in the percentage of labour employed in different sectors in each country. [8]

Question 2

SRT makes a wide range of paints. These are sold to businesses and customers in many countries. Market research is important. The Managing Director said, ‘Different countries have different legal standards for paint. Customers want different colours and sizes of tins.’ SRT uses the services of many businesses from the tertiary sector.

Suggest three important businesses SRT might use from the tertiary sector. Justify your choices. [12]
Enterprise, business growth and size

Learning summary
By the end of this unit you should understand:
- the characteristics of successful entrepreneurs
- the contents and importance of a business plan
- the different methods and problems of measuring business size
- why some businesses grow and others remain small
- why some businesses fail.

3.01 Characteristics of successful entrepreneurs

Entrepreneurs invest their time, skill and money to set up a business. Anyone can be an entrepreneur if they have the necessary qualities.

- Risk-taker
- Strong leader
- Creative
- Innovative
- Effective communicator
- Initiative
- Motivated/determined
- Entrepreneur: someone who organises, operates and takes the risk for a new business venture.

3.02 How business plans assist entrepreneurs

A business plan can help a business. It can:
- support loan applications (for example, a bank is more willing to lend if it can see it is likely to be repaid)
- give a sense of purpose and direction so the employees know what to do to achieve the plan
- help decision-making so time and resources are not wasted
- help understand possible risks, especially if it is a new business.

TIP
A business plan is not just for new businesses.

TERMS
Entrepreneur: someone who organises, operates and takes the risk for a new business venture.
Business plan: this contains the aims and objectives of a business, and important details about its operations, finance and owners.
3.03 How and why governments support business start-ups

New businesses can offer many benefits to the economy and consumers.

• Jobs create lower unemployment.
• Increased competition could lead to more choice or lower prices.
• They can provide specialist or new services.
• Start-up businesses, if successful, could grow into large businesses.

Governments provide a range of support including:
• Financial – grants and subsidies, lower tax rates
• Information, advice and support
• Location – enterprise zones, rent-free spaces
• Training courses for entrepreneurs and/or workers.

3.04 Methods and problems of measuring business size

Small, medium or large business? Size can matter. Being large could indicate business growth or a lower risk for lenders. There is no perfect way to measure size.

<table>
<thead>
<tr>
<th>Measure</th>
<th>How it is measured</th>
<th>Possible problems with using this measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of employees</td>
<td>Number of workers in the business</td>
<td>What happens if a business uses a lot of machinery?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>What if it has lots of part-time employees?</td>
</tr>
<tr>
<td>Capital employed</td>
<td>Amount of money invested by owners/borrowed from lenders</td>
<td>Any business can have a lot of expensive machinery, so capital employed is high.</td>
</tr>
<tr>
<td>Value of output</td>
<td>Amount of output over a given period</td>
<td>How can this be compared if different types of products are made?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>What if not all of the products are sold?</td>
</tr>
<tr>
<td>Value of sales</td>
<td>Value of sales over a given period</td>
<td>A firm might sell a few high value items while another firm may sell many cheap items.</td>
</tr>
</tbody>
</table>

Table 3.01 Measuring the size of a business organisation.

TIP

Profit is NOT classed as a measure of size. This is because too many factors influence the amount of profit made.

3.05 Why owners may want to expand the business

Growth is an objective for some businesses. Advantages include:

• Economies of scale – leading to lower average/unit costs.
• Diversification/spread risk – so the business is less reliant on one market or product.
• Financial reasons – higher profits, or able to borrow money more easily.
• Personal objectives – power and status.
• Market domination – increased power or market share in existing markets, so the business can gain more influence with suppliers and customers.
• Access to new markets.
3.06 Different ways a business can grow

There are two ways a business can grow: internally and externally.

<table>
<thead>
<tr>
<th>Method</th>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>By expanding its own activities</td>
<td>By taking over or joining with another business</td>
</tr>
<tr>
<td>Advantages</td>
<td>✔ Able to keep control</td>
<td>✔ Much quicker so gain benefits of growth faster</td>
</tr>
<tr>
<td></td>
<td>✔ Relatively inexpensive as business can use own resources</td>
<td></td>
</tr>
<tr>
<td>Disadvantages</td>
<td>✗ Very slow process</td>
<td>✗ Harder to control</td>
</tr>
<tr>
<td></td>
<td>✗ Change of ownership?</td>
<td></td>
</tr>
</tbody>
</table>

Table 3.02 Advantages and disadvantages of internal and external growth.

TinPot makes metal cans for drinks. Let’s look at the different ways it might grow in Figure 3.03.

Sample question

Rafa owns a successful jam-making business. He started ten years ago and has made a profit every year. All the jam is sold at local markets. Rafa wants to grow his business. He cannot decide whether to start making sweets or try to find a new market for his jam.

Recommend to Rafa which way he should choose to grow his business. Justify your answer. [6]

Sample answer:

Rafa has no experience of sweet-making [1] so it will take time to learn these skills [1], and even if he does there is no guarantee of success [1]. He is known for his jam so this reputation can help attract new customers. [1] While sweets might help to spread risk, as he is already successful [1] it would be safer to try to broaden his target market [1].

External ways to grow

- Merge with supplier: metal mine
- Merge with competitor: tin-making business
- Unrelated merger: clothing business
- Merge with customer: soft drinks business

Figure 3.03 Ways TinPot could grow
3.07 The problems of growth

Growth (internal or external) does not guarantee success.

<table>
<thead>
<tr>
<th>Problems of growth</th>
<th>Different options to overcome problems</th>
</tr>
</thead>
<tbody>
<tr>
<td>Harder to manage and control</td>
<td>Hire specialist managers</td>
</tr>
<tr>
<td></td>
<td>Review organisational structure</td>
</tr>
<tr>
<td>Communication problems</td>
<td>Use two-way communication methods (see 9.03)</td>
</tr>
<tr>
<td></td>
<td>Delegate and involve employees in decision-making</td>
</tr>
<tr>
<td>Financial problems</td>
<td>Use long-term sources of finance (see 19.02)</td>
</tr>
<tr>
<td></td>
<td>Grow at steady rate</td>
</tr>
<tr>
<td>Lack of focus</td>
<td>Set clear objectives</td>
</tr>
</tbody>
</table>

Table 3.03 How to overcome problems of growth.

Sample question

ARG is a large food retailer. It has 1200 shops and has 160,000 employees across country A. The Managing Director of ARG plans to take over HBC, which sells electrical goods such as televisions. She said, ‘The food market is very competitive. Customer demands and technology are constantly changing. I know many of our stakeholder groups will be affected.’ HBC has 800 shops and 47,000 employees.

Identify and explain **one** advantage and **one** disadvantage for ARG’s business of taking over HBC. [8]

Sample answer:

**Advantage:** Spread risk. As it is in a competitive market, ARG’s food sales might decline as customers choose rival products. This way, ARG has another market to rely on for revenue. [4]

**Disadvantage:** Harder for ARG’s management to control. The new business will have 2000 shops and 207,000 employees, so it could take much longer for decisions to reach all employees, if at all. As customer demands are constantly changing, ARG might be too slow to react and lose sales to rivals. [4]

3.08 Reasons why some businesses remain small

- Demand in market may not be large enough so it is not possible to grow.
- The business offers specialist goods or services (niche markets).
- Owners want to be their own boss.
- A small business can be more flexible, and able to react to market changes quickly.

3.09 Why some businesses fail

Not all businesses will be successful. Both established and new businesses can and do fail.

New businesses are at higher risk, as they are not established in the market. It can be difficult to persuade customers to try a new product. Owners may lack experience to make the right decisions. Raising finance and cash flow are common problems.

![Figure 3.04 Reasons why some businesses fail.](image-url)
### Progress check

1. What does the word ‘entrepreneur’ mean?
2. Outline one problem of using employees as a measure of business size.
3. State two ways a business can grow internally.
4. Identify two reasons why a business might remain small.

### Summary

Entrepreneurs are people who start up new businesses. Governments try to support such businesses. The size of business can be measured in many ways. Many businesses will want to grow while others remain small.

### Sample questions

**Example 2:**
Identify and explain two characteristics Grace needs to be a successful entrepreneur. [6]

**Sample answer:**
- **Characteristic 1:** Risk-taker [1]: 80% of new businesses fail [1] so she must be prepared to lose all her savings [1].
- **Characteristic 2:** Effective communicator [1]: as beauty salon is a service; [1] she needs to encourage people to return [1].

**Example 3:**
Identify and explain two ways in which a government might help Grace’s business. [6]

**Sample answer:**
- **Way 1:** Financial support [1]: Grace only has $400 [1] and is likely to have high start-up costs [1].
- **Way 2:** Advice [1] to help make better decisions [1] as only has some experience [1].
Examination-style questions
Glass Brothers (GB) is a successful small glass-making business. It is a business partnership owned by two brothers, Kai and Kit. GB makes a range of products from windows to bottles, in an old factory near the city centre. Kai has been looking at GB’s business plan. He wants to grow the business but cannot decide the best method to use. Kit, the Production manager, wants to develop new products. A local window-fitting business has offered to join the two businesses together.

a Identify two ways to measure the size of a business.
Way 1:
Way 2:

b Identify and explain two possible benefits to GB of having a business plan.
Benefit 1:
Benefit 2:

[2]

[4]

[8]

c Identify and explain two possible problems for GB’s business if it grows too large.
Problem 1:
Problem 2:

[8]

d Do you think joining with the other business is the best way for GB to grow? Justify your answer.

[12]