

Section I: UNDERSTANDING BUSINESS ACTIVITY

Unit 1

Business activity

Learning summary

By the end of this unit you should understand:

- the concepts of needs, wants, scarcity and opportunity cost
- the importance of specialisation
- the purpose of business activity
- the concept of added value and ways to increase added value.

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.

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.

1.03 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 employees 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.

TERM

Specialisation: when people and businesses focus on activities they are best at.

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:

Type of factor	Description of factor
Land	includes all natural resources as well as the space used for production
Labour	the employees
Capital	the finance, machinery and buildings used to produce goods and services
Enterprise	the people who organise the land, labour and capital

Table 1.01 The four factors of production.

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.

1.05 Adding value

Most businesses buy resources to make products. These raw materials are altered to make them worth more money, so the business can sell them at a higher price.

Worked example

Tickers make watches. The materials cost \$50 and Tickers sell the finished watches for \$150. Tickers pay employees \$60. Other costs including rent are \$15. What is the added value? The answer is: \$100.

This is not all profit. Only the amount left after all the costs have been covered is profit: \$25.

TIP

Remember that added value is NOT the same as profit.

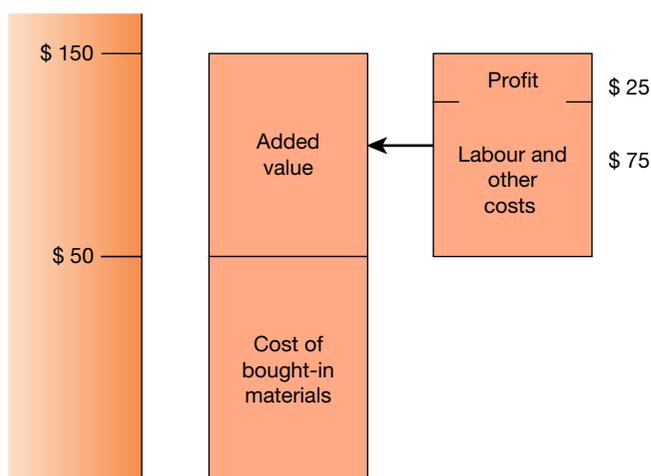


Figure 1.01 Summary chart: added value at Tickers.

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.

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.

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 Define 'scarcity'.
- 2 What is the difference between a need and a want? Give an example of each.
- 3 Explain the main purpose of business activity.
- 4 State **two** factors of production for a market trader.

Sample questions

Example 1:

Define 'factor of production'. [2]

Sample answer:

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

Example 2:

TGA is a leading manufacturer of mobile phones.

Outline **two** ways in which TGA could increase added value. [4]

Sample answer:

Way 1: add new features [1] such as better camera zoom. [1]

Way 2: create a strong brand image [1] so that people are willing to pay more for its phones. [1]

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 Define 'opportunity cost'. [2]

- b Identify **two** factors of production.
 Factor 1:
 Factor 2: [2]
- c Outline **two** benefits to NSN of increasing added value.
 Benefit 1:
 Benefit 2: [4]
- d 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.

Name of sector	Primary	Secondary	Tertiary
Main activity	Extract	Make	Service
Example	Cotton farmer	Clothing factory	Transport company or retailer

Table 2.01 Summary of the three sectors.

TIP

Some businesses can be involved in more than one stage of production.

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.

Define '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.

2.02 The changing importance of business classification

The size of each sector varies among 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?'

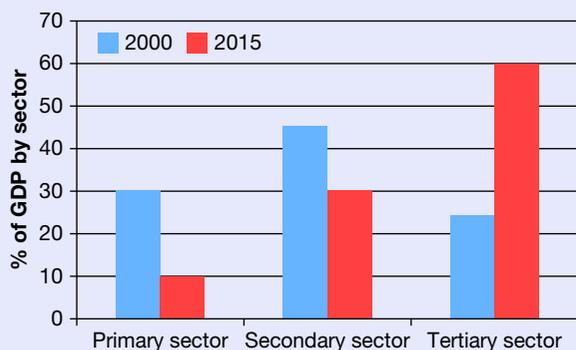


Figure 2.01 Country C percentage of Gross Domestic Product (GDP) by sector.

NOTE: GDP has risen from \$500m in 2000 to \$700m in 2015.

Identify **two** changes shown by the data in Figure 2.01. For each one, explain a possible reason for the change. [6]

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.

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?

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.

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.

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]

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.

	Country A	Country B
Primary sector	45	10
Secondary sector	20	20
Tertiary	35	70

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:

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

Explain **four** important tertiary sector businesses that SRT might use. [8]

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.

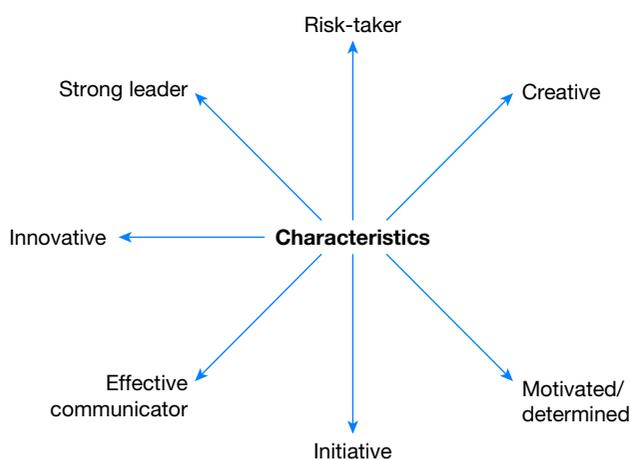


Figure 3.01 Characteristics of an entrepreneur.

TIP

An entrepreneur can be categorised under 'enterprise' in the factors of production (see 1.04).

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.

– Aims and objectives
– Details about the product
– Market information, for example size of market, customer information, competitors
– How and where product is to be made
– Number and type of employees
– Finance required, cash flow forecasts

Figure 3.02 Main sections of a business plan.

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.

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

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.

Method	Internal	External
	By expanding its own activities	By taking over or joining with another business
Advantages	<ul style="list-style-type: none"> ✓ Able to keep control ✓ Relatively inexpensive as business can use own resources 	<ul style="list-style-type: none"> ✓ Much quicker so gain benefits of growth faster
Disadvantages	<ul style="list-style-type: none"> ✗ Very slow process 	<ul style="list-style-type: none"> ✗ Harder to control ✗ Change of ownership?

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.

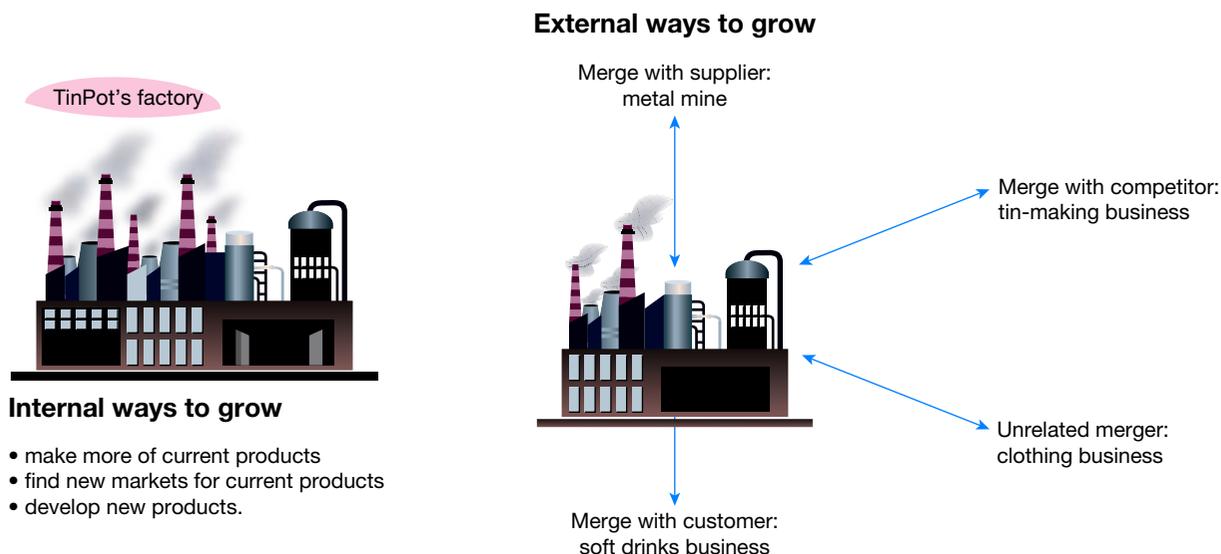


Figure 3.03 Ways TinPot could grow

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.

Which method of expansion do you think Rafa should use? 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].