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# Business

Malcolm Surridge and Andrew Gillespie



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# Business

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Malcolm Surridge  
Andrew Gillespie



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## Student's CD contents



Key terms

Answers to short answer questions

Interactive tests

Examination structure, Planning your revision and Examination technique

# Introduction

## The textbook

This book introduces you to Business. It has been written to meet the requirements of the Cambridge International Examinations syllabi for AS and A Level. It provides coverage of the entire syllabus although we have divided some modules and combined others to make the subject more convenient for you to study.

The book will guide you through the Cambridge International AS and A Level Business programme of study, although you should supplement it with research into businesses in your own and other countries. You are fortunate that there is an immense amount of information available about businesses, their behaviour and the environments in which they operate. The internet is an enormous and valuable resource and you will find much relevant information in magazines, newspapers and on television programmes. However, business activity takes place around you all the time: when you are shopping, travelling to and from school or college or enjoying leisure activities such as visiting the cinema. There are many opportunities for you to see the operation of some of the theories and models that you will study.

This textbook includes the following features:

- guidance as to the material that is covered in each chapter
- definitions of key terms to assist you in mastering the language of Business
- maths moments to help you to develop relevant numerical skills
- study tips to help you to prepare for examinations in Business
- diverse case studies to illustrate how theories and concepts operate in the real world
- a range of questions and activities to help you to reinforce your learning and to develop the skills needed to succeed in examinations in Business
- a selection of past Cambridge examination questions.

A new feature of the syllabus is Key concepts. These are the essential ideas, theories, principles or mental tools that help learners to develop a deep understanding of their subject, and make links between different topics. An icon indicates where each Key concept is covered:

### Change

Change is the only constant. Exciting new enterprises are often created in response to economic, cultural or technological changes. Existing businesses must adapt to change if they are to survive and grow.

### Management

Management is relevant to every person in a business. Good leadership, strong motivation in workers, effective systems and clear communication are hallmarks of successful businesses.

### Customer focus

Customer focus means a business will design and produce goods and services that people want to buy. Customers provide the revenue which sustains a business. Successful businesses really understand their customers and strive to provide products that their customers love.

### Innovation

Innovation enables a business to re-invent itself and stay ahead of the competition. The business world is dynamic and companies must seek to innovate through product development, more efficient processes and finding better ways 'to do business'.

### Creating value

Creating value is the core reason why any organisation exists. Effective organisations aim to maximise stakeholder value. For most businesses this will be about maximising shareholder value, but social enterprises will also have other, non-financial, aims. Stakeholders also need to measure the value that is created.

### Strategy

Strategy is about knowing where you are, where you want to get to and how you are going to get there. Managers need to think about, decide on and put into action major long term plans – such as buying another business, entering a new market or developing a new technology.

## The Student's CD-ROM

Accompanying this book is a Student's CD-ROM which we hope will help you further with your study of this subject. The CD-ROM contains the following features.

- 1 The answers to all the short answer questions included at the end of each chapter.
- 2 A selection of additional interactive tests designed to assess and strengthen your knowledge and understanding of Business. Answers are provided to these questions.
- 3 A glossary of key terms for AS and A Level Business.
- 4 Material to assist you in preparing thoroughly for your examinations in Business.

## The structure of the Cambridge syllabus

### AS Business

Students taking AS Business will take two examinations.

#### Paper 1 Short answer and essay

- This paper has two sections: Section A contains about four compulsory short questions; Section B comprises three essays based on the AS syllabus content from which you have to choose one.
- The examination lasts for one hour and fifteen minutes.
- This paper represents 40 per cent of your AS marks or 20 per cent of the A Level.
- The paper can be sat in October/November or in May/June each year.

#### Paper 2 Data response

- The paper is made up of two compulsory data response questions based on the AS syllabus content. Each of these contains some text and sometimes tables and graphs as well.
- Each question has about four elements which range from definitions to questions requiring discussion.
- The examination lasts for one and a half hours.
- This paper represents 60 per cent of your AS marks or 30 per cent of the A Level.
- The paper can be sat in October/November or in May/June each year.

### A Level Business

Students taking A Level Business will take the two AS examinations described above plus Paper 3 below.

#### Paper 3 Case study

- This paper has two sections.
- Section A contains a case study and approximately five compulsory questions of varying mark allocations. All these questions are based on the case study.
- Section B comprises two essays, also based on the case study, from which you have to choose one.
- The questions on this paper are based on the Additional A Level syllabus content.
- The examination lasts for three hours.
- This paper represents 50 per cent of the A Level (the AS papers make up the other 50 per cent).
- Paper 3 can be sat in October/November or in May/June each year.

## Succeeding in Business examinations

Examinations in Business require you to understand the relevant theories and concepts set out in the syllabus. This means that you have to learn the material set out in the appropriate sections of this textbook. However, this is not enough on its own. The examinations will also require you to organise ideas, construct arguments, make decisions, solve problems, conduct calculations and interpret data. You will need to complete as many practice and past questions as possible to develop these examination skills. Finally, it is important for you to apply many of your answers to the business scenarios set out in the data response materials or case studies that are a key part of the examination papers. For example, if a question is about retailers, you must relate your answer to retailers to achieve a high grade.

This textbook contains numerous questions throughout and at the end of each chapter, all of which have been designed to help you to develop these essential examination skills.

Business is a subject that will have relevance to your future life, whatever you choose to do. We hope that you enjoy studying it and wish you good fortune in your examinations.

*Malcolm Surridge & Andrew Gillespie*

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# 1 Enterprise

## Chapter overview

In this chapter we examine:

- the nature of business activity; for example we look at what businesses do and the purpose of business
- the role of the entrepreneur; for example we consider why entrepreneurs are important to the economy
- social enterprises; these are businesses that are not set up to make a profit but to benefit society.

## 1.1 The nature of business activity

### The purpose of business activity

What will you do this weekend? Have you got a part time job to earn some money? Are you going to go out to the cinema or shopping in the town centre? Whatever you do you will come into contact with many different businesses either as a consumer buying and using their products or as an employee working to create them. Businesses are everywhere! Just think of the last time you went shopping – the outlet where you shop is a business, it has bought the products from a supplier, they were transported by a delivery business and the firm probably uses another business to help promote itself. In every transaction between a customer and a business, many other businesses will have been involved to bring about that exchange.

There are many different definitions of a business but what they tend to have in common is the idea of someone (or a group of people) working in an organised way to achieve a given target. Notice the key elements of this definition – firstly, the activities of those involved are organised in some way and secondly, the business is created with a specific purpose in mind: often the **business objective** is profit but as we shall see later there are many other reasons why people set up in business. Using a definition of organised activities and a given target, many organisations such as

hospitals and even schools could be classified as businesses. They may not have profit as a target but they do involve many different people working together, planning and organising what they do to achieve targets such as helping people get better more quickly or improving the quality of students' education.

### Key term

**Business objectives** are measurable targets set by the business such as sales or profits that have to be achieved within a given time period.

## The transformation process

All businesses are involved in the transformation process. They take inputs and transform them in some way to produce outputs that they hope consumers will want.

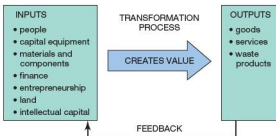


Figure 1.1 The transformation process

### Inputs

The inputs into a business include:

- land
- labour
- capital
- intellectual capital.

### Land

This involves choosing the location of the business. This is critically important for businesses such as shops and cafés. For other businesses such as farming, what will matter is the quality



of the land in terms of the ability to grow different crops. The success of a farming business will be directly affected by changes to the quality of the land and the weather. The significance of land as an input will be particularly high in the **primary sector**.

### Key term

The **primary sector** is the first stage of production and includes extracting or growing resources. Farming, mining and fishing are all part of the primary sector.

Under the heading of land we also include premises. The amount of space available to a business can affect how much can be produced or how many customers can physically fit in the restaurant or store. The nature of the premises can also affect the working environment and people's motivation. For example, working in a modern office with a good canteen, parking spaces and a central location might be appealing to employees.

### Labour

Organisations will need staff. The quality of employees in terms of their skills, their attitudes (e.g. to customers), their willingness to work and their natural abilities will have an influence on the success of any business. What makes a film a blockbuster? The quality of the writing, the acting and the production – people play a key role in the success of any film. Many films therefore promote themselves on the basis of who the actors are. Similarly, universities promote their professors. Music labels promote their bands. Publishers promote their author list. So people can be a crucial element of the transformation process.

### Capital

The word 'capital' has many meanings. In this instance, we mean the equipment used by businesses. The coffee machines in the coffee shop, the ovens in the fast-food restaurants, and the scanning equipment in shops are all examples of capital equipment. The amount and quality of equipment in a business can affect the service it provides. For example, the online retailer Amazon is admired for the efficiency with which it processes an order and is able to make suggestions to customers of what else they might like to buy.

### Intellectual capital

Intellectual capital involves the intelligence of the workforce. This includes the ability to develop new ideas, find new solutions to problems and spot business opportunities. Success does not just depend on what resources you use but how you use them, which is why intellectual capital is so important.

The choice of inputs and who supplies them can affect:

- the costs of a business
- the quality of the final product (and therefore sales).

In recent years, customers have become increasingly interested in what resources are used in a production process and where they

have come from. Firms may highlight the fact they use recycled materials or that their ingredients are 'natural' or 'organic'.

Firms will also face the choice of whether to buy in some materials or produce them themselves. Tyrrell's Potato Chips uses the fact that it grows its own potatoes when it promotes its products. Most other crisp manufacturers buy in their potatoes.

### Outputs

The output of a business may be in the form of goods or services, or a combination of the two.

- A good (or a product) is a tangible item, such as a car or a laptop computer. A good is a physical item. Businesses can produce and stock them. This means that they can produce in advance of demand: for example, a store may stockpile new electrical goods before a busy selling period.
- A service is intangible. Services include education, creating music, hairdressing and physiotherapy. Most businesses in more developed economies are in the service sector. Services cannot be stored: they have to be produced for customers as they are needed. This can create problems because if there is a rush of customers there are no products stockpiled and so queues form or waiting lists have to be introduced.

In many cases, a business provides a combination of goods and services. For example, you may choose a restaurant because of the food you can eat there (the goods) but also because of the waiters, the environment and the way you are treated (the service).

Most outputs are intended for sale. A firm produces goods and services to sell to customers. However, there may also be by-products from the transformation process: for example, a firm's production may create waste and pollution. Many customers pay attention to these issues and, increasingly, firms are considering the effects of their production on other groups, such as the local community.

### Case Study

#### Dabbawalla



Figure 1.2 A busy dabbawalla delivery in Mumbai

Every day in Mumbai, India, around 250000 people get their lunches delivered by 'dabbawallas'. A 'walla' means a 'doer of something' and a 'dabba' is a stainless steel lunchbox. The lunch is picked up from the person's home and taken to a sorting station. The lunch boxes are then divided up according to destination and delivered on bike, on foot or taken on the train to their destination. After lunch the box is collected and taken back to the person's home. This is an incredibly efficient but very labour intensive and low technology process with almost no boxes going missing or to the wrong address. The price is so low that it is easier to pay for the delivery than take your lunchbox with you on your journey to and from work.

## Questions

- 1 Explain the transformation process of the dabbawallas in terms of input and outputs. [6]
- 2 Discuss how you would measure the success of this process. [10]

For most products there is a series of stages in the transformation process involved in taking the initial materials and ending up with the final product. The author J.K. Rowling took her imagination, a computer and paper and turned this into magical manuscripts for her Harry Potter books. The publishing company worked with the author, designers, a marketing team, a printing business, a distribution business and turned the manuscripts into a series of books. Book stores take a range of books and transform them into a retail experience for the customer. A series of transformations has gone on to get the idea from the author's mind into a book and into the hands of the reader.

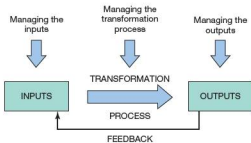


Figure 1.3 Chain of operations

Businesses need to identify exactly what they want to provide in terms of the range and quality of products they offer; do they want to specialise in a few types of items or provide a wide range of goods and services? Businesses also need to decide on the resources they will need to provide the product to the standard they want for their customers. There are a number of questions involved here: How many people are needed? What skills are needed? Will they be trained? What materials will be used? What equipment? And so on. Businesses need to find a way of generating a product that customers value so much that they will pay more for it than its cost to produce.

## Case Study

### Transformation processes

There are many different forms of transformation. These include:

- changing the characteristics of materials, information or customers. For example, manufacturers take components and build something new with them. Beauty salons and cosmetic surgeons take people and improve their appearance (we hope!). Doctors, dentists, physiotherapists, psychiatrists and teachers all help us to improve some aspect of ourselves. Accountants take our receipts and turn them into a set of accounts to show investors or government tax inspectors.
- changing the location of materials and information. Federal Express and Cathay Pacific simply move items or people around. Google helps you find something that is already there – it helps you to access information. An estate agent gives you information on houses that you might be interested in. This service saves time and money for the seller and helps the buyer sell the property more quickly.
- changing the ownership of materials. Wholesalers buy in bulk from a number of producers. Retailers then buy from wholesalers because it is easier to deal with them than with every single producer: it reduces the number of transactions and makes the process simpler.

Source: Adapted from Open University material at: <http://openlearn.open.ac.uk>

## Questions

- 1 Explain the nature of the Federal Express transformation process. [6]
- 2 Discuss the possible reasons why a business might review and change its transformation process. [10]

When designing its transformation process a business person must consider questions such as:

- What level of output will be provided? Are you aiming to produce hundreds, thousands or millions of units? How many customers do you want to be able to have?
- What quality of service will be provided? How many people will you have serving in your shop? Will you deliver your products to people's homes? What will your policy be if people want to return items?
- How will you provide the service? Will you provide it online or via shops? Will you use high staffing levels or invest in more equipment?
- What aspects of the process will the business undertake for itself and what elements will be outsourced to or bought in from other providers? You may decide to manage the shop yourself but get cleaners in to tidy up, employ accountants to do the finances and use specialists to design the décor. You may produce a range of clothes but simply do the design work

yourself and get someone else to produce them like Benetton; alternatively, you may manufacture them yourself like Zara. All these decisions will have an impact on the costs, flexibility and the complexity of running your business.

The transformation process is ongoing and dynamic. If the output you produce is not acceptable or needs to be improved you will have to change the inputs and/or the way you produce. You will then monitor the results and, if necessary, change again. Change may also be due to external factors. For example, increasing concern about the environment has influenced what is produced and how it is produced.

## Creating value

Value is created when outputs are produced that are worth more than the inputs brought in to produce them.

For example, artists such as Andy Warhol, Vincent van Gogh, David Hockney and Rembrandt took their imagination, paint and canvas and produced amazing works of art that sell for millions of dollars: far more than the cost of the items used up in their production. They created value via the transformation process.

Jamie Oliver, a famous cook, takes standard ingredients such as meat, herbs and vegetables, then puts them together in a unique way and comes up with a fantastic meal. He takes ingredients that many others may use but transforms them in a way that appeals to customers, packs out his restaurants, sells books and attracts viewers for his TV series. Clearly, he has created value by using his talent, creativity and personality.

Creating value can be done in ways that may seem odd. Here are some examples:

- Some companies buy new jeans and then stretch them, batter them and fray them to make them look distressed while, at the same time, more than doubling their price.
- A bottled water that was initially sold for \$10 a bottle comes from King Island, near Tasmania. It is called 'Cloud Juice' and is claimed to be the purest in the world. It is rain water that has been collected from a plastic roof and then bottled. It is supposed to be so pure because it comes from rain clouds that travel 7000 miles from South America without passing over any land and therefore not encountering pollution.
- One of the most expensive coffees in the world is Luwak Coffee. This is made from coffee cherries that have been eaten and digested by common palm civets (a type of animal). The civets use their keen sense of smell to select the choicest and ripest beans. The beans are supposed to be much sweeter as a result of the digestion process and, having passed through the animal, they are hand-collected from the jungle floor.

To increase its created value, a business might aim to:

- reduce the costs of producing the product. This means cutting back on waste, ensuring the best price for the supplies and making sure that mistakes are not made. All activities that do not create value need to be examined to see if they are truly necessary.

- increase the perceived benefit of the product in the eyes of the customer. This could be through building the brand, developing a unique selling proposition (USP) or differentiating it through the service provided.

### Study tip

When answering questions you may need to think about how different firms create value. What can businesses do to add more value? Should they focus on the benefits they are providing, or try to control costs more effectively?

## Businesses and economic activity

Businesses make up an important part of any economy. They are important because they employ people, they pay employees' wages and salaries and they provide goods and services.

Businesses provide the products we buy and give us the jobs and earnings we need to buy them. When businesses are doing well and expanding they employ more people and generate more income for the economy. Businesses innovate to win more customers: they create new goods and services and this can improve the quality of our lives by providing better food, better clothes and better electronic goods. Businesses therefore drive economies forward and this is why governments are eager to help new firms start up and compete, and why they often try to help businesses grow.

## Choice and opportunity cost

In any economy there is a fixed amount of resources at any moment and therefore decisions have to be made about how these resources are used. Given the scarcity of resources, choices are inevitable in terms of what should be produced in the economy, how these products should be produced and who should receive them. Some of these decisions will be made by market forces: it will be the result of bargaining between consumers and businesses. If, for example, demand for a particular product increases, this will encourage businesses to use their resources to produce this instead of something else. Imagine you were a farmer and had limited land. You have to decide what to grow on it. This will depend in part on demand: if the demand for a particular crop increases you may switch to this and away from something less in demand.

Some decisions about what to produce and how to produce may be made by the government. For example, the government may provide some or all of the health services, the transport system or the education system in a country.

Governments tend to take control of goods and services they think are vital to their economy and where they want to ensure access for most people.

However, whenever decisions are made about what to produce – whether it be the free market or the government – it will involve an opportunity cost. Given that resources are limited, if they are used to produce more of one item, then this is at the expense of something else. Opportunity cost measures the sacrifice you make if you choose one course of action in terms of the next best alternative. For example, if a business decides to use its labour force to increase output of soft drinks then the opportunity cost is what could have been produced if the labour force had been used to produce something different. Whenever a business makes a decision it should consider the opportunity cost. A project that earns a profit of \$100 000 may seem attractive but if the resources could have been used to earn \$250 000 it is not so appealing. When judging the success of a business you should consider the opportunity cost. If Walmart, the huge US retailer, makes a profit of \$10 million this may not be that impressive given the people, stores and equipment it has.

## The business environment

Businesses do not operate in isolation. What they do is linked to what other businesses do, for example, their suppliers, the firms that distribute and promote their products, the banks that lend them money. They are also affected by many other external factors such as:

- **Political and legal issues.** For example, new laws by a government can prevent the way some products are promoted (such as cigarettes) and can affect the way employees must be treated and the way a business produces (perhaps to reduce its environmental impact).
- **Economic issues.** For example, the amount of income in an economy can change over a period of time, affecting demand; the value of one currency in terms of another can alter, affecting the cost of importing supplies; and the cost of borrowing can go up, increasing costs.
- **Social issues.** For example, an increase in the size of the population or a change in the life expectancy of the population in a country can affect the level of demand and the types of products people buy.
- **Technological issues.** For example, changes in the availability and speed of the internet can make it easier to find suppliers and sell across the world.

These external factors (known as PEST – political, economic, social and technological) will continually be changing and this will affect what businesses produce and the resources they use. If labour costs in one country become more expensive, for example, businesses might switch production to another country or start to use more machinery instead. If a government signs a treaty with another country to make trade easier its businesses might start to sell more to customers in the new partner country. Businesses therefore need to monitor their external business environment because it is dynamic (ever changing) and if necessary managers will need to change some of their decisions about inputs, the transformation process or the outputs they produce accordingly.

### Study tip

Remember that the key external factors in the environment of a business will vary from industry to industry. In the health sector, demographics may be very significant; in the computer sector, technological changes may be critical. You need to assess the key issues for any given industry.

### Case Study

## Brazil

The Brazilian economy has been growing fast despite a slowdown in many other economies around the world. In 2012, the National Institute of Economic and Social Research (NIESR) said that Brazil had overtaken the UK in terms of the size of its economy. The Brazilian economy is now worth \$2.5 trillion (£1.6 trillion) (compared to the UK's \$2.48 trillion), making it the sixth biggest economy in the world.

Brazil is enjoying an economic boom because it is benefiting from revenue selling its food and oil at high prices.

Brazil is the largest Latin American economy and one of the so-called BRIC nations together with Russia, India and China. Its growth has been far faster than the US and western Europe in recent years.

With substantial oil and gas reserves being discovered off the coast of Brazil, the country is now the world's ninth largest producer of oil. Brazil has about 190 million people, in contrast to the UK's 60 million people.

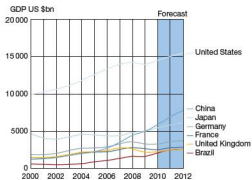


Figure 1.4

Source: IMF

### Questions

- 1 Explain two possible reasons why the Brazilian economy might be growing so fast. [6]
- 2 Discuss the possible effects for Brazilian businesses of operating in such a fast growing economy. [10]