A2 – Business and its environment

Revision chapters 3-7

Business structure

Local, national and multinational businesses

Main differences between local, national and multinational business

Local businesses are active in a specific town, area or region within a country. They tend to be small- to medium-sized businesses that meet local customer needs, e.g. hairdressers, independent food shops and repair shops, such as radio and television repairs.

National businesses operate on a country-wide basis and might have branches in many regions of a country. Due to operating in several parts of a country, these businesses tend to be larger than the majority of local businesses. Although branches might exist to serve a small area, the business itself is one of national standing.

Multinational businesses operate in more than one country. They frequently produce and sell products in several countries, sometimes adjusting their products to meet the specific preferences of different countries. Multinational businesses produce and trade across national boundaries.

Multinational businesses: operate in more than one country. The head office is located in one country but branches of the business exist in several countries.

1 Distinguish between a national and a multinational business.
2 Briefly explain one advantage and one disadvantage of the development of international trade links

The growing importance of international trade links and their impact on business activity

International trade links can be formed between businesses or as a result of governments reaching trading agreements. Links will be pursued and agreed when both parties believe that they can benefit. For example, coffee growers will form links with a coffee processing business if they can secure a market for their coffee beans at a fair price. The coffee processing business will benefit from knowing that they have a secure supply of coffee beans and of a quality that they can trust.

Governments might reach trade agreements with different countries in order to enlarge the potential market for goods produced in their own countries.

The benefits to business of international trade links

- A larger potential market — possibly a global market.
- The potential for growth of a business.
- Economies of scale.
- Possibly fewer restrictions placed on the import/export of goods to and from other countries.
- Lower import duties might be agreed by the participating governments.
- There could be a beneficial sharing of expertise.

Possible disadvantages to business of international trade links

- Businesses are likely to be exposed to competition from businesses in other countries. For example, if import duties are reduced, then overseas businesses will be able to sell goods at a cheaper price than previously. This can put pressure on the price that the national businesses can charge. This can potentially reduce their profit.
- Meeting the needs of a wider variety of customers might mean a greater variety of products need to be produced, causing a lack of economies of scale.
- Some countries have lower wage rates than others, therefore this is likely to influence the price charged for finished goods that might be significantly cheaper than home produced goods. This could lead to a loss of jobs in some countries.
- Not all goods are acceptable for sale in all countries, e.g. alcohol. Therefore, businesses must be fully aware of any restrictions on the type of goods that can be sold.

Multinationals

Multinationals and the state: advantages and disadvantages

Benefits to a country

- The multinational business might bring substantial investment into a country in terms of technology and skills development.
- Increased employment if the multinational recruits locally.
- The infrastructure might be improved to accommodate the multinational business. It might make some improvements as part of an agreement with the host government.
- An increase in the variety and possible quality of goods offered for sale in a country.
- Lower prices for goods produced or sold by the multinational.
- If the multinational is profitable, the host country can benefit from an increase in tax revenue paid to the government. Tax paid can be income tax from employees as well as tax on profits.

Disadvantages to a country

- The arrival of a multinational business might prevent infant industries in the host country from becoming established.
- The multinational might demand tax concessions for locating in a particular country, therefore depriving the government of potential tax revenue.
- Multinationals often bring their managerial staff with them and therefore the jobs offered in the local market might only be the lower-skilled ones. This can dilute the benefits to the host country in terms skills development.
- Some multinationals have a larger turnover than the gross domestic product (GDP) of some host countries. This can produce an unequal balance of power in favour of the multinational that might cause some governments to allow activities that would otherwise not be acceptable. For example, a multinational that breaches employment legislation or causes pollution might not suffer the same consequences that a smaller business might. The multinational might threaten to withdraw from the country.

3 Briefly explain one reason why a government might encourage a multinational to locate in its country.

4 Identify one disadvantage to a country of a multinational locating there.

Privatisation/nationalisation

In recent years it has been more usual, in most countries, for **privatisation** to occur rather than **nationalisation**. In virtually all economies there are now privatised and nationalised businesses/organisations.

Many governments prefer market forces to determine business activity providing that all relevant laws are complied with. This means that business activity that previously took place under public ownership now occurs in the private sector. Examples in the UK include the production and supply of gas, electricity and telecommunications.

Advantages and disadvantages of privatisation or nationalisation

Advantages of privatisation

- When a previously state-owned business is not privatised as one business, increased competition between the smaller privatised units should result and that should improve the service and drive down prices to customers.
- Privatisation allows access to different sources of finance through the stock exchange and banks.
- The sale of state-owned businesses provides an inflow of finance for the government that can be used to meet other priorities.

Disadvantages of privatisation

- Once the business is sold to the private sector, and if it becomes highly profitable, that revenue is lost to the government.
- Privatised businesses will be run to make a profit and the needs of customers might not be a priority. This is particularly possible when there is a lack of competition within an industry or when movement between businesses is difficult.
- Once a state-owned business has been sold, the government no longer has control over how it operates and what its objectives are.
- Economies of scale might be lost as large and perhaps unwieldy businesses are broken up into smaller units.

5 Identify one advantage and one disadvantage of nationalisation.

6 Briefly explain why a government might not want to privatise a strategic industry.

Privatisation: the transfer of ownership and control of a business/organisation from the public sector to the private sector (from government ownership into ownership by private individuals).

Nationalisation: the transfer of ownership and control of a business/organisation from the private sector to the public sector (from private ownership to government/state ownership).

Advantages of nationalisation

- Essential goods and services can be provided at a price that the population can afford.
- Strategic industries, such as the provision of electricity or gas and the defence industry, can be kept under state control, removing the possibility of them being controlled by a hostile country.
- Employment levels can be influenced by the number of jobs provided through state-owned businesses.

Disadvantages of nationalisation

- Decision making can be very slow due to the involvement of government departments.
- The businesses might not be run as efficiently as possible because a priority is the provision of essential goods and services rather than the profit motive.
- Any funding will be provided by the government, which reduces the amount that can be spent elsewhere. This will probably be taken from tax revenues.

Public/private partnerships

Governments in many countries have seen the benefits of some businesses/organisations being jointly owned and controlled by the government and private organisations. These are known as public/private partnerships.

Public/private partnerships are appropriate in cases where a privatisation would not be in the best interests of the population but where some input from private businesses can be beneficial. The benefits can be in terms of business skills or in the form of financial support.

The nature of public/private partnerships including private finance initiatives (PFI)

In many countries, the provision of services such as health, education and transport have been judged appropriate for joint ventures between the state and private businesses/individuals.

Some organisations are funded by governments but the day-to-day activities are carried out by private organisations. For example, some health provision is sub-contracted to private individuals or organisations but the funding is provided by the government. This removes the government from the need to provide the actual services on a daily basis. The private sector has been judged to be more efficient in the provision of some services.

Some agreements involve government initiatives being funded by money from the private sector. For example, some schools and colleges in the UK have been funded by private investors.

Revision activity

Draw up a table with three categories across the top: healthcare, education and transport. For each category, list as many advantages and disadvantages (a) of it being purely state-owned and controlled and (b) of it being totally privately owned and controlled.

Finally, list the possible impact on each of these services of public/private partnerships and/or PFI.

Size of business

External growth

External growth is usually a faster means of expansion than internal growth. It involves either **mergers** with other businesses or **takeovers** of other businesses. Growth achieved in this way is often referred to as horizontal integration or vertical integration.

Many modern businesses have grown in a way that has allowed them to diversify and therefore gain some protection from a downturn in one particular market. Other businesses have sought to secure their supply chain by merging with or by taking over their suppliers.

The different types of merger and takeover

Horizontal

Horizontal growth is the merging with or taking over of a business in the same economic sector, e.g. if a tea packaging business merged or bought out a coffee packaging business and if a chain of restaurants merged with another restaurant chain. The merger of two restaurant chains might, for example, make them stronger and more likely to survive.

Vertical

Vertical integration takes place between businesses in different economic sectors, e.g. if a coffee processing business merged or took over a coffee plantation or if a furniture manufacturer merged with a large forestry business. In both of these cases, the joining of the businesses would be to ensure a supply of the raw materials by the manufacturer and might equally be to secure a market for the raw materials on the part of the primary sector business.

Conglomerate

Conglomerate integration is when businesses from different industries and often also from different stages of production merge or are taken over.

Integration does not need to be within the same industry. A clothes retailer could decide to diversify and buy an existing chain of coffee shops — different type of business but both in the tertiary sector.

A clothes retailer could decide to buy into a forestry business because it believes forestry to be profitable. There is not any link between the businesses other than their common ownership.

Friendly and hostile takeover

A merger is a joining of two or more businesses when both sets of owners consent. A takeover can be either agreed by all parties involved, a friendly takeover, or it can be against the wishes of the owners of the business being bought, i.e. a hostile takeover. A friendly takeover occurs with the knowledge and often the agreement of the owners of the business that is being taken over. However, a hostile takeover is seen as an aggressive act on the part of the business that is forcibly acquiring another business. This can be achieved by buying sufficient shares on the stock exchange to gain a controlling interest in the other business. A business can buy shares in another business often without the target business being aware that a takeover is in progress until it is too late and the predator business has acquired sufficient shares to gain control, though there may be laws that require the predator to declare its intentions once a certain percentage of shares have been purchased.

Impact of a merger on the various stakeholders

Table 1 Potential impacts on some stakeholders of a business

	Owners	Managers	Employees	Suppliers	Customers
Advantages	• More status. • Larger more competitive business. • Realisation of capital gain.	• Promotion. • More responsibility. • More status.	• Status of working for a larger business.	• Potential for larger orders.	• More variety. • Lower prices as economies of scale are gained.
Disadvantages	• Some loss of control. • Relocation — the merging businesses might relocate on one site.	• Fear of job loss as fewer managers might be required. • New, unfamiliar systems might be introduced.	• Fear of losing job. • Employment practices might change. • Location of job could change.	• Suppliers of the other business might be retained.	• Product quality might change. • Product range might change.

7 Briefly explain the difference between a merger and a takeover.

8 Give one disadvantage of a takeover to the employees of a business.

Expert tip

Questions often ask you to give advantages or disadvantages to a business or to the employees or other stakeholders. Make sure that you take note of that focus in your answer. Students frequently explain advantages when disadvantages are required. This does not seem to happen the other way round as often!

Why a merger may or may not achieve objectives

A merger might be successful because:

- The new, larger business can achieve economies of scale and become more competitive due to:
  - more purchasing power with suppliers
  - managerial economies, e.g. the new, larger business would only require one finance director
- The status of the business might be raised in the eyes of customers, making their products more appealing.

A merger might not be successful because:

- The larger business becomes difficult to control, i.e. diseconomies of scale are experienced.
- The feeling of insecurity among employees might continue as new systems are introduced, perhaps leading to a higher labour turnover.
- The businesses might find that their cultures are too different to allow effective collaboration.

Revision activity

Draw up a table with stakeholders not in Table 1 and list the possible advantages and disadvantages that they might experience as a result of a merger.

9 Briefly explain one reason why the merger of two businesses might not be successful.

Joint venture: when two or more businesses contribute their expertise to a business venture. The businesses do not merge but work together for the purpose of the separate business activity/project.

Strategic alliance: an agreement between two or more businesses or organisations to link their activities as in the example of the coffee processor and the coffee growers.

Expert tip

A joint venture or strategic alliance allows each business to remain as a separate operation, able to withdraw or change the relationship if needed.

Revision activity

Think of other businesses that might benefit from joint ventures or strategic alliances and make notes of the ways in which the arrangement might be mutually beneficial.

The importance of joint ventures and strategic alliances as methods of external growth

An alternative means of growth that does not involve any change in ownership is the formation of joint ventures and strategic alliances. These occur when two or more businesses believe that working together, perhaps only on one specific project, can be beneficial to each business.

Joint ventures can involve businesses sharing resources to produce a product for sale or to provide a service. The venture must yield benefits to all the businesses involved in order to be worthwhile.

A **strategic alliance** would also be mutually beneficial but it might, for example, be in the form of medical care and education being provided to a part of the world that a business relies on for some of its materials. This form of alliance benefits the local inhabitants because they receive better education and healthcare. The business benefits because the local community is healthier and better educated. The business can also ensure that the local labour force is educated in the skills that are required by the business.

The businesses can benefit from:

- pooling their financial resources
- sharing expertise that each business individually might not have
- gaining access to different markets, e.g. if an alliance was formed between a business in the UK and one in India or China

One example of a strategic alliance that might be formed is between a coffee processor and some of the farmers growing the coffee. By forming this alliance:

- The coffee growers can be given the financial help and perhaps some additional input of expertise to enable them to increase the amount and the quality of their crop.
- The coffee processing business might provide the initial cost of planting and of some of the equipment that can improve the growing and harvesting process.
- The coffee processing business would be having some control over the quality of the coffee beans that it received as well as some assurance that the coffee grower could continue to grow the beans.

10 Outline one benefit of joint ventures.

External influences on business activity

External influences affect the business environment and determine the framework businesses operate in. They include the actions of the state and governments and their associated policies, relevant laws and international agreements, technology, and social and environmental factors. Businesses have to take all these into account when making decisions. Analysts use the acronym PESTLE to summarise these influences:

- **P**olitical
- **E**conomic
- **S**ocial
- **T**echnological
- **L**egal
- **E**nvironmental

Economic constraints and enablers

The role of the state

The state and government play a major role in determining the business environment. Governments have large spending programmes and these have to be financed from taxes and borrowing. A government has a responsibility to make sure that the country it is governing has an appropriate environment for businesses to operate in, e.g. that the population is well educated, prices are not rising too fast, infrastructure is in place and relations with other countries are good. Objectives like these are **macroeconomic**, i.e. concerned with managing the overall economic conditions. Governments can also act to create the right conditions for individual businesses and consumers at their level.

Expert tip

In many countries there is an assumption that the private sector produces goods and services most effectively. There must therefore be a reason why the state would provide these goods and services or intervene to regulate or support private sector businesses.

11 Give two reasons why the state might intervene to help or constrain businesses.

How the state might intervene to help or constrain businesses

Macroeconomic level — helping businesses

Governments try to create the right conditions for businesses by ensuring that:

- the finance system is able to make money available to businesses
- the right number of educated workers are available
- prices do not rise too fast
- consumers have enough income to spend on goods
- exchange rates do not vary quickly or too much
- different regions do not differ too much in terms of income or unemployment

Individual businesses level

At an individual business level, governments will help businesses by providing:

- grants, subsidies and low-cost loans for investment
- roads, railways, airports and broadband
- skilled government consultants and agencies to assist with business problems
- advice to different sized businesses or those in rural or high unemployment areas

State intervention to constrain businesses

State intervention and constraints on business include:

- taxes, which reduce profits or increase costs
- laws to promote or enforce health and safety and consumer protection
- regulations on presenting fair and accurate accounts

How the state might deal with market failure

Market failure occurs when the price mechanism and the laws of supply and demand fail to produce an outcome that is socially desirable. Examples include:

- education for all
- streetlights
- refuse collection
- utility networks
- consumer protection and labelling
- medical and hospital services for everyone
- roads, railways, ports and airports
- a legal system and police forces
- defence and national security
- public open spaces

In all these cases, it is very unlikely that a privately owned business will be able to provide these facilities and make a profit. The state will step in and be the provider. It can do this directly by providing these things as in the case of a national health service, an army or local government taking rubbish away. Another option is for the state to use private businesses to provide these services by contracting out (outsourcing), franchising or licensing.

Governments' key macroeconomic objectives and their impact on businesses

Governments set objectives for the economy, which they try to achieve by using policies. The priority placed on each objective will determine which policies are implemented, when and by how much. It is this implementation that is important for businesses rather than just the setting of objectives. Important government objectives include achieving:

- low **unemployment**
- low **inflation**
- stable **exchange rates**
- **growth**
- **transfer of wealth**

Low unemployment

People who want to work should be able to find work. The reason governments have an objective of low unemployment is because high unemployment is a cost to a country as it causes:

- a waste of human resources that lowers overall production and economic growth
- social problems like drug taking and personality problems
- a cost to the whole country in benefits, lost taxation and increased crime levels

Possible impact of high unemployment on businesses

High unemployment means there are relatively more workers seeking the available jobs. In turn this causes:

- a low consumer income, which means sales are lower and competition is greater, leading to low output, low profits and pressure to cut costs and lower prices
- redundancies and rationalisation
- a consumer switch to lower-priced, lower-quality products
- employees fearing the loss of their jobs, which means they will work harder and complain less
- easy recruitment of already skilled employees
- low wages as scarcity of jobs means workers will work for less
- investment falls

Low inflation

Inflation is a persistent increase in the general level of prices. Rising prices mean that the value of money in a country falls. The reason governments have an objective of low inflation is that a high level means uncertainty because it:

- erodes the value of savings and makes borrowing more attractive
- makes planning and fixing contracts difficult
- might lead to hoarding

Possible impacts of high inflation on businesses

Possible impacts of high inflation on businesses are:

- increased borrowing for investment as asset values will rise with no effort
- increased costs of materials, fuel and labour
- it is easier to increase prices and pass on price rises of materials and labour
- consumer spending lowers as prices rise
- price becomes a more important marketing mix element
- increased pressure from employees for higher wages
- increased difficulty in tracking and setting prices
- a country's products become less competitive and less attractive to foreign investors

Unemployment: occurs when some workers who want to work cannot find jobs.

Inflation: a persistent increase in the general level of prices.

Exchange rate: the price of a currency in terms of other currencies.

Growth: an increase in economic activity, usually measured by a rise in gross domestic product (GDP).

Gross domestic product (GDP): the total value of the output of a country in 1 year.

Transfer of wealth (or wealth redistribution): when governments use taxes, subsidies or regulation to move wealth from one group in society to another.

Expert tip

Remember that a decrease in inflation means that prices are rising less quickly, not that they are falling.

Stable exchange rates

The exchange rate of a country's currency is its price in terms of other currencies. A stable exchange rate means that this price is remaining the same over time so that the price of exports and imports will not keep changing. This makes planning easier. Exchange rates are only one factor in decisions on exporting and importing.

Possible impact of unstable exchange rates on businesses

Stable exchange rates make planning easier and more certain for importers and exporters.

- Rising exchange rates mean that exporting businesses become less competitive. Prices of exports rise in the importing country and the volume of exports falls. The extent of the fall will depend on the price elasticity of demand.
- Rising exchange rates mean that importing businesses become more competitive. Prices of imports fall and the volume of imported goods increases. The extent of the increase will depend on the price elasticity of demand.
- Falling exchange rates mean the reverse of the above.

Growth

Growth is an increase in economic activity, usually measured by a rise in gross domestic product (GDP). Economic growth means there is more wealth, and on the whole consumers will be able to buy more and governments can provide more facilities such as education, health services and infrastructure. Growth can be achieved by more use of resources, higher investment, a more skilled workforce, higher exports, or higher consumer spending.

Possible impact of economic growth on businesses

- sales and profits increase as consumers' incomes rise
- sales of luxury items rise relatively more than basic products
- new product launches are likely to increase
- investment and more new technology is more likely
- employment increases, unemployment falls
- tax revenues increase
- it may be more difficult to recruit suitable skilled labour

Transfer of wealth or redistribution

Governments are concerned not just with the level of GDP and income but with which groups in the country have the wealth and income. Governments generally have objectives related to this. For example, they might wish to:

- pay benefits to those on low incomes, the unemployed or disabled
- get those on high incomes to pay relatively more taxes
- transfer wealth and income from richer to poorer parts of the country
- provide cheap housing for those on low incomes
- encourage or discourage certain products or industries

Possible impact of wealth transfer on businesses

- Income tax, wealth/property taxes and benefits will redistribute income and wealth from richer to poorer and spending patterns will alter.
- Profit taxes may vary by the amount of profit made.
- Businesses in areas of low unemployment may be able to receive subsidies or grants.
- Certain industries may get subsidies, e.g. renewable energy suppliers, or have to pay more taxes, e.g. fossil fuel businesses.
- Groups who gain or lose will have certain spending characteristics and these will affect businesses in those areas.

15 State the effect on prices for each of the following changes:

(a) price of imports if exchange rates rise

(b) price of exports if exchange rates rise

17 Outline two reasons why a government might wish to transfer wealth from one group in the country to another.

18 For each of your two reasons, give an example of how two specific groups might be affected.

Changing macroeconomic objectives

Governments face different situations at different times so their objectives will change. An economy with full employment and economic growth is more likely to emphasise objectives such as low inflation or wealth transfer. An economy with low unemployment, some inflation but facing wildly changing exchange rates might focus on stabilising the exchange rate. An economy with high inflation may focus on this first and see growth and employment fall.

A complicating factor is that macroeconomic objectives often conflict. It is very difficult to achieve all five objectives at the same time, as a policy to achieve one often leads to being unable to achieve another.

Typical conflicts in achieving objectives

- Achieving low unemployment may mean high growth but also high inflation.
- Transferring wealth from rich to poor may mean it is not worth low-income groups working so unemployment rises.
- Achieving low inflation may mean low growth and high unemployment.
- Stabilising exchange rates may mean low growth.

Policy instruments used to achieve macroeconomic objectives

Governments have a range of economic policies they can use to achieve objectives but these mostly fall into monetary, fiscal or exchange rate policies.

Monetary policy

Monetary policy is using government controls over interest rates or the amount of money (money supply) to achieve policy objectives. The rate of interest is the price of money. Changing interest rates will alter the cost of borrowing for those who wish to take out a loan. If rates rise, it will be more expensive to borrow so less will be borrowed. This has the effect of:

- Reducing investment spending because it is more expensive to borrow to pay for the money to fund machinery or equipment.
- Reducing consumer spending because interest on mortgages, credit cards and loans will increase and so fewer goods will be purchased. Repayments of existing loans, such as credit cards, rise so there is less money left over for spending. In addition, saving will become more attractive so less will be spent.
- Raising exchange rates because rising interest rates will make a country more attractive for foreign financial institutions to put money into.

Changing the amount of money in the country will also influence the total available for banks to pass on for consumer spending or investment. Increasing the money supply can be done by:

- Selling more government debt to the banks (quantitative easing) to enable more money to be available to businesses.
- Reducing the amount of secure reserves banks need to hold, so freeing up more money for lending.
- Lowering restrictions on bank lending.

Lowering interest rates or expanding the money supply will lead to increased consumer spending and investment and higher economic growth. Inflation may increase if this growth is small, and the effect on exchange rates will depend on by how much imports increase as growth may lead to greater exports too.

Fiscal policy

Fiscal policy is the use of taxation and government spending to achieve economic objectives. Governments can choose from a range of possible taxes, each one with its own effect on different groups. Major taxes include:

- income tax on individuals
- profit taxes on businesses
- taxes on sales or value added
- taxes on particular goods, e.g. alcohol, petroleum, carbon or tobacco duties

Major government spending areas include education, health, defence, transport and benefits to individuals. Businesses may gain from subsidies or grants.

Increasing taxes will have the effect of taking money out of the economy so growth is reduced, unemployment may grow and inflation may fall. Increasing government spending may result in inflation, growth and a fall in unemployment. The precise effects depend on what taxes are changed and which areas of government spending change.

Exchange rate policies

Exchange rate policies are actions taken to influence the exchange in a desired way. Monetary policy will have an impact on the exchange rate because lowered interest rates will make a currency less attractive to foreign investors. They take money out of the country's banks so the exchange rate will fall. It is possible for a government to use exchange controls to limit the amount of money moving in and out of a country, but in today's global world this is effectively very difficult. Some countries tie the value of their currencies to stronger currencies or use public relations to try and influence opinion about their strength.

Table 2 The effects of exchange rate changes on business

	Effect on exporters	Effect on importers	Effect on domestic market
Exchange rate rises	• Export price rises. • Sales volume falls. • Sales value change depends on price elasticity of demand.	• Import price falls. • Import quantity rises. • Sales value change depends on price elasticity of demand.	• Import price falls. • Lower costs for imported materials. • Increased competition for domestic producers.
Exchange rate falls	• Export price falls. • Sales volume rises. • Sales value change depends on price elasticity of demand.	• Import price rises. • Import quantity falls. • Sales value change depends on price elasticity of demand.	• Higher import prices. • Higher costs for imported raw materials. • Decreased competition for domestic producers.

Choice of policy instrument

Governments have to address economic issues they currently face and choose appropriate policy instruments. First, the cause of the problems must be established before choosing a policy to address the cause. These decisions are usually difficult and have different possible solutions to achieve the objectives. Other possible policies include **supply side policies**. These focus on freeing up businesses to become more efficient by relaxing regulations, providing efficient infrastructure and helping provide a well-trained, skilled workforce. The key thing for business studies students is to consider what effect a given policy might have on businesses.

Supply side policies: policies that attempt to make businesses run more efficiently and have lower costs. They include: better infrastructure, relaxing regulations, lowering trade union influence, grants and subsidies for investment and helping provide a better skilled workforce.

Table 3 Possible effects of macroeconomic changes and policies on business behaviour

Macroeconomic change	Possible policy	Effect of policy	Possible business behaviour
High unemployment or economic growth	Monetary — lower interest rates or increase money supply	• Loans become cheaper. • Households spend more as borrowing becomes cheaper and more spending money is available. • Exchange rate falls as foreign money leaves banks.	• More investment. • More borrowing. • Production increases to meet extra demand. • More employees are hired. • Exporters face higher prices. • Importers face lower prices.
	Fiscal policy	• Lower income taxes so households spend more, especially on luxury products.	• Increase production to meet demand. • Producers of luxury goods increase production.
		• Lower sales taxes so prices fall.	• Increase production to meet demand.
		• Lower profit taxes.	• Lower prices. • Production increases to meet demand.
		• Higher government spending leads to an increase in consumer demand and government contracts.	• Production increases, especially government contractors. • Businesses move to seek government contracts.
High inflation	Monetary policy — raise interest rates	• Borrowing becomes more expensive. • Households spend less as borrowing gets more expensive and less spending money is available.	• Production falls. • Marketing increases. • Prices are reduced. • Search for new markets.
	Fiscal policy	• Higher income taxes so households spend less.	• Prices fall to encourage purchases. • Production falls. • Marketing increases. • New products. • Search for new markets.
		• Higher sales taxes cause price rises.	• Lower profits. • Cost cutting.
		• Higher profit taxes.	• Profits fall. • Investment falls. • Cost cutting. • Relocation to lower tax country.
		• Decreased government spending causes less consumer demand and government contracts.	• Profits fall. • Redundancies/rationalisation in government suppliers. • Search for new markets.

Expert tip

When analysing the effects of changes in the economic environment consider one change at a time and imagine that all other factors are constant.

The effect of changes in macroeconomic performance and policies on business behaviour

There are infinite combinations of macroeconomic variables and policies. It is important to look at the effects of each variable on its own, assuming all other variables are constant. Table 3 sets out some possible effects of changes in macroeconomic variables and policies but there are many others.

19 A country is facing high unemployment, low growth, low inflation and a stable currency.

(a) Identify two appropriate macroeconomic objectives for the government.

(b) Outline two policies a government may adopt to achieve these objectives.

Corporate social responsibility (CSR)

Corporate social responsibility is the actions, legally required or voluntary, needed for an organisation to act responsibly to all its stakeholders. CSR includes acting in an ethical way, respecting the people, communities and the environment that the business affects and balancing the claims of stakeholders. Acting on CSR might:

- reduce environmental problems such as pollution and climate change
- mean long-term needs are put ahead of short-term goals
- be behaving in the right way
- reduce exploitation of one group by another, e.g. profits for shareholders may mean very low wages for employees

CSR includes:

- accurate accounting procedures that reflect the true value of assets and cash flows
- not paying bribes to win contracts
- paying a fair wage and providing healthy and safe working conditions
- buying raw materials from sustainable sources
- acting to reduce pollution beyond the legal requirements
- making suppliers conform to an ethical code of conduct
- not outsourcing to poorly paid or child workers or where low health and safety standards operate
- a social audit or CSR report of stakeholder objectives, establishing CSR indicators, measuring these and regularly reporting on them

20 Explain the meaning of corporate social responsibility.

21 Identify three stakeholders in a business manufacturing shoes, including at least one external to the business.

22 Give one reason why it might be difficult for a business in a developing country to act in a socially responsible way.

Arguments for CSR

- Better financial performance as customers are attracted and costs are looked at carefully.
- Can be a marketing advantage in brand image and reputation.
- Lower costs, e.g. recycling or lowering waste.
- Customer loyalty.

Arguments against CSR

- Expensive and raises costs and prices.
- Makes businesses uncompetitive, especially in a global marketplace.
- Stakeholders cannot agree on ethical/socially responsible behaviour.
- A luxury in a time of recession.
- It is a fashionable, cynical way to market a business.

Political and legal influences on business activity

Government and the law

Governments have a responsibility to make sure that the business environment is one where competition is fair, workers have healthy and safe conditions, consumers are given accurate information and are protected from faulty or dangerous products and that businesses are encouraged to set up in the best places to contribute to the life of the country. They do this through passing laws and using regulations to achieve these objectives. Much of this is aimed at the primary objective of improving the way that markets work so that they are fair to everyone involved — producers, suppliers, advertisers, consumers, employees, investors, society as a whole.

Employment and conditions of work law

Employment law varies from country to country, but most countries have laws that deal with most if not all of these topics:

- protection of health and safety of employees
- minimum pay or wage levels
- contracts of employment, unfair dismissal and redundancy arrangements
- prevention of discrimination against certain groups of people based on their characteristics, e.g. disability, age, religion, gender, sexual orientation
- parenting rights and workplace harassment/bullying
- membership of trade unions

These laws add costs, and create the need for record keeping and employees to monitor them, but they also lead to more committed and secure employees and less costs as there will be fewer accidents, legal costs and court cases.

Competition law is a cost to government and businesses that have to check they are in line. It requires sophisticated analysis of markets and may take time to be introduced in a way that works.

Marketing behaviour — consumer protection law

Businesses are very often large or small enough to disappear easily if there is a problem. This means that compared to consumers, they have a lot of power if there is a problem. Businesses may be tempted to sell faulty or unsafe products or to use persuasive unethical selling techniques to get consumers to buy. Most countries have laws that relate to these areas ensuring that:

- goods are not faulty, are safe and are fit for the purpose for which they are sold
- goods and services provided are as they are described
- weights, measures and sizes are accurate
- food products are safe to eat and prepared in hygienic conditions
- advertising gives accurate descriptions of the products or services and does not exploit anyone, e.g. children

These may add costs or limit the way a business may behave, but governments have a responsibility to make sure that consumers are protected. Having laws means businesses quickly adapt to the requirements and consumers can have more confidence when they buy.

Competition law

Goods and services are sold in markets where there is competition between providers. Businesses might be able to limit competition to their own advantage, e.g. by getting together and all agreeing to sell at a high price, forcing consumers to pay more than if there was real competition. **Competition law** aims to bring about as much competition as possible so that suppliers are encouraged to become more efficient, lower costs and prices, and provide choice to consumers. Competition law usually deals with fair trading requirements and pro-competition laws.

Fair trading requirements banning unfair practices

Unfair practices include:

- price fixing and price agreements
- information sharing agreements
- producers refusing to sell to retailers unless minimum prices are set
- sole supplier arrangements — suppliers only supply if no competitors are allowed
- predatory pricing

Pro-competition laws

These include:

- banning cartels
- investigating monopolies to make sure that these are not acting against consumer interest
- investigating proposed mergers and takeovers to make sure they will not result in unfair monopoly power

Other laws, including location decisions and particular products

Governments have a range of other laws that affect businesses. For instance, there may be planning requirements to be met when setting up a factory, office or shop. There may be restrictions on pollution that require equipment to clean up smoke or chemicals. There may be noise limits on industrial premises, limits to lorry movements or business operations may be restricted to daytime hours.

Particular products may have specific laws that apply to them, e.g. explosive substances, drugs, chemicals that require safe particular storage solutions.

The impact of international agreements on businesses

Most countries have signed up to a number of international agreements setting up common regulations and behaviours. Businesses must then act in line with the agreements. Examples include:

- World Trade Organization or regional trade agreements on freeing trade
- United Nations-based Kyoto agreement on restricting carbon emissions
- International Labour Organization standards on employment conditions
- United Nations Law of the Sea setting out mineral rights, fishing rights and ownership rights
- internationally agreed accounting standards

Particular examples include businesses having to:

- design products to meet particular standards of safety
- reduce pollution or use less energy
- set out their accounts to include corporate social responsibility factors

23 Give two reasons why governments have passed laws that affect business behaviour.

24 Identify two areas of business activity that are affected by law.

Revision activity

Draw up a list of the benefits and problems for a supermarket considering introducing a point-and-press scanning system for shoppers, which will record all purchases and generate a detailed database of purchases linked to payment methods and e-mail addresses of customers. It will mean that nearly all the tills will not be needed.

Technological influences on business activity

Technology is now key to business success in all areas.

Production

- Design based on information collected from market research using IT and the internet.
- Computer-aided design.
- Manufacturing using computer-aided manufacturing and robotics.
- Fracking to produce previously unobtainable gas supplies.
- Genetically modified plants and animals.
- 3D printers.

Operations

- Enterprise resource planning.
- Electronic point-of-sale systems to link sales, stock and ordering.
- Access to online information and data.

Communications

- Mobile computing and home working.
- Video conferencing.

Marketing

- Databases to sell to particular identified groups or individuals.
- E-mail and social networks to communicate with customers directly.
- E-commerce — global on-line sales outlets.

Table 4 The benefits and problems of introducing technological change

Benefits	Problems
More efficiency, less waste.	Cost of researching new technology.
Improved products and services directly tailored to consumers' needs.	Cost of new technology that may date quickly.
New materials, designs, products.	Investment in wrong technology is easy and expensive.
Faster more detailed instant communication.	Jobs disappear; retraining and new skills needed; resistance from employees.
Increased quality and quality control.	More pressure on employees.

Other businesses and business activity

Businesses are constrained by and rely on other businesses

Businesses never operate on their own. They are always part of a supply chain, either as a supplier or purchaser. They may rely on agency staff, use marketing agencies, consultants, energy suppliers and transport businesses. They will use internet providers, search engines and telephone networks. The actions of competitors will affect their behaviour and plans. Government agencies may place legal requirements on activities and pressure groups, trade unions and consumer groups may have a large influence.

Social influences on business activity

The need to consider the community and pressure groups

Businesses operate in a society that may be affected by business activity. Society is a stakeholder and increasingly acting as an influence on business decision making. Businesses are not separate from social change and have to take account of social needs including:

- the changing role of women
- environmental issues
- sustainability and energy concerns
- ideas of fairness and equality
- perceptions about wealth and income distribution

Many of these needs are reflected and articulated by pressure groups such as Greenpeace, Oxfam or a trade union. These groups gain publicity in the media that both reflects and affects consumers' buying behaviour. It may be in the interests of a business to engage with pressure groups and work with them to change so that social needs and attitudes are reflected better. Failure to engage may lead to the government forcing change by passing laws following lobbying by pressure groups. Examples might include the pressure for:

- more women to enter the workforce.
- a higher percentage of women to become senior managers
- more environmentally friendly processes of production

Failure to respond may lead to fewer sales and less profit, lowered employee motivation, difficulty in recruitment, poor public relations and internal conflicts.

Many businesses are finding that having an ethical approach or engaging in corporate social responsibility has a positive effect on sales, consumer perception and the employees, and use this as a marketing tool, e.g. line caught tuna fish is sold as a sustainable catch and fair trade products appeal to an increasing number of consumers in richer countries.

Demographic change and business activity

How a business might react to a given demographic change

Demography is the study of population structure and its changes. It is concerned with age, gender, ethnic origin, migration and education levels. It deals with how birth and death rates and migration affect these. Demography is vital to business activity because it is related to patterns of demand and employment.

Demand and demography

People with different characteristics, such as age or gender, have different demands for products — men and women buy different types of clothes and read different types of books.

Effects of age

A society with increasing percentages of older people will:

- spend relatively more on holidays and travel, health products and eating out
- need more care homes and medical services but spend less on music, electronic goods and entertainment
- require governments to pay more pensions so taxes may rise

On the other hand, a society with a high percentage of people aged under 15 will:

- have relatively high demand for toys, baby food and children's clothes
- face increasing demand over time for products appealing to young adults then families

Effects of changing ethnic mix

A more ethnically diverse population will demand a wider range of clothing, food and possibly of religion related products.

The demographics in a particular country will affect the opportunities for business activity, some firms will find their products in a declining market, some in a growing market

Employment and demography

Effects of age

- Older workers tend to be loyal to the employer, have experience, be less likely to move jobs or location, and are possibly more reliable and less likely to be absent.
- Younger workers tend to cost less, be flexible, willing to move and able to learn new skills but may need more family/parenting leave.

Effects of education levels

A society with a low percentage of people with school or university qualifications will have a low-skilled inflexible workforce that forces employers to offer training programmes.

Effects of changing ethnic mix and migration

- Different ethnic groups may have different expectations regarding facilities at work, or working hours.
- Immigrants may have different skills or be willing to work for lower wages.

Expert tip

It is important to be able to understand that demographics affect demand and employment patterns and to be able to apply this understanding to a specific situation involving a specified business.

Influence of environmental issues on business activity

All business activity will change the physical environment. Concerns are growing that this process has reached a point that is not healthy for human beings or the planet. There are many pressure groups acting to try and reduce the impact on the global and local environment, and governments are passing laws and putting pressure on businesses to try to reduce the impact of business activity on the environment.

Ever more businesses are changing their policies and practice to reflect these concerns and regulations. Examples include:

- A more explicit focus on corporate social responsibility in relation to pollution, waste disposal and recycling.
- Building environmental audits into planning.
- Focusing on environmental policy in marketing material.
- Changing to obey new environmental laws and regulations.
- Engaging with and responding to environmental campaigners and pressure groups.
- Developing more energy-efficient, sustainable solutions to raw material supplies, operations planning and product design.

Revision activity

Prepare notes for a presentation to the board of directors of the following companies on how their operations might be affected by a greater concern for the physical environment:

- a computer manufacturer
- a law firm
- a forestry company