AS Business Studies
Business and its environment

Revision for chapters 1-5

Enterprise

Enterprise is the qualities and skills needed to start up and create a new business venture. It involves understanding the nature of business activity and the conditions required for business success.

The nature of business activity

Purpose of business activity

Business activity can be looked at in two ways:

1. **The transformation of inputs into outputs.** The **inputs** are resources: the **factors of production** (land, labour, capital and enterprise). These incur financial costs: rent, wages, interest on loans and payments to business owners. The **outputs** are physical products or services represented by sales revenue or profits.
2. **The use of resources to supply goods and services to meet the needs and wants of consumers and society.** These may be private needs from individuals and households, or social needs like medical services, transport and education.

In doing these activities, jobs and incomes are created, goods and services are produced and the lives of individuals and society are improved. Enterprise involves the process of taking decisions about the best way for a new business to transform inputs and meet the needs of individuals and society. Taking these decisions always includes elements of risk, and enterprise deals with assessing these in relation to possible rewards.

Factors of production: these are the following resources used to produce goods and services:

- Land, including buildings, minerals, oil and forests.
- Labour — work done either manually or mentally in managing and decision making.
- Capital — machinery and equipment, including intellectual capital such as education and qualifications.
- Enterprise — the qualities and skills needed to start up and create a new business venture.

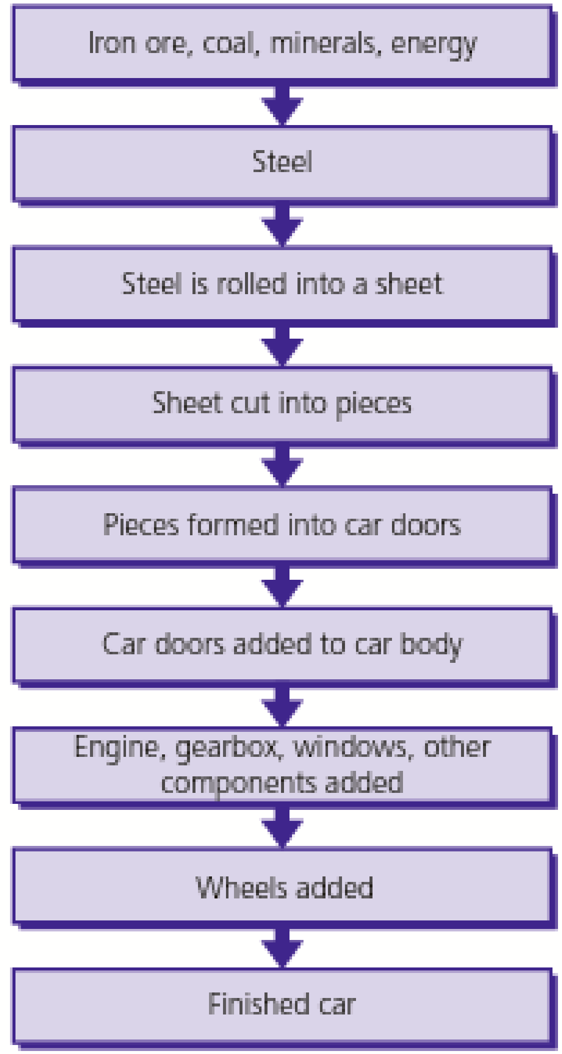
The concept of adding value

When transformation of inputs to outputs takes place to produce goods and services it occurs in a number of stages. Each stage is more valuable than the one before as work will have been done on the inputs (economic added value). This value will also be the added value that consumers place on a finished product (marketing added value). The example opposite shows how value is added at each stage of production in car manufacturing.

Example

Car production

Each stage of production shown below adds value by transforming inputs into an output.



The nature of economic activity, the problem of choice and opportunity cost

Economic activity means taking decisions about the transformation of inputs to outputs and always involves choices. This is because resources are always limited in relation to needs and wants. Individuals, businesses and society generally always want more than they can afford so choices must be made.

Opportunity cost is the real cost of making a decision about using resources. The real cost of something is what is given up when you choose it.

Table 1 Opportunity cost examples

Individual examples	Opportunity cost
Studying A levels	Not taking a job
Taking a holiday by the sea	Not visiting mountains
Buying a shirt	Not buying some shoes
Business examples	**Opportunity cost**
Buying a new computer network	Not buying new lorries
Spending on research and development	Not increasing advertising
Hiring some workers	Not being able to lower price
Society examples	**Opportunity cost**
More hospitals	Fewer soldiers and weapons
Powerful cars	Safer roads
Lower taxes	Less government spending on education

Businesses need to be aware of the opportunity cost of any action before they make final decisions.

Opportunity cost: the next best alternative given up when a choice is made.

Revision activities

1. Draw up a list of five different businesses. Briefly explain how each business adds value.
2. Using the same businesses draw up a list of decisions each business might have to make and show the possible opportunity cost of making each decision.

1. Define 'added value'.
2. Define 'opportunity cost'.

Business environment is dynamic

Businesses operate in an environment that includes:

- the actions of other businesses
- the labour market
- government economic and social policies
- consumer tastes and demand
- the legal framework
- political factors
- social and demographic factors
- changing technology

All these change over time. Some changes may take place slowly, such as an ageing population, increasing incomes or consumers wanting increasingly better-quality products. Some change is quick, such as a new competition law or a competitor decreasing price. Businesses have to monitor their environments and be ready, able and willing to change what they are doing in order to adapt to changing markets. Carrying on in the same way is an option that often leads to failure.

What a business needs to succeed

The keys to business success are effectiveness in the following areas:

- **Enterprise** — the ability to see possible opportunities in the market for transforming inputs to outputs and gaining a reward that takes into account the risks and choices involved.
- **Organisation** — the ability to choose the appropriate resources and combine them together profitably to produce products at a price the consumer is willing to pay.
- **Financial monitoring** — keeping track of the flows of money in the organisation so that decisions on resources can be made knowing the real opportunity cost.
- **Human resource management (HRM)** — so that the right number of appropriately skilled and trained people are hired.
- **Marketing** — so that products meet the consumers' needs in terms of design, price, availability, information and value.
- **Objectives** — so that appropriate organisation structure and strategy can be used.
- **Coordination** — so that all the functional areas (finance, marketing, operations, HRM) work together to achieve corporate objectives.

Why many businesses fail early on

As many as 60% of businesses fail in the first 2 years. Common reasons include:

- lack of well-researched objectives and business plan
- too little cash (cannot afford appropriate resources), or too much cash (spent on wasteful resources)
- too much borrowing, leading to high interest payments
- cash-flow difficulties (spending at the wrong time or not getting payments quickly enough)
- unexpected growth too soon, which stretches resources
- unplanned-for competition and lack of market knowledge and research
- poor marketing, i.e. too much, too little or not appropriate
- poor initial location decision or credit arrangements
- lack of experience and underestimation of time and money pressure
- not enough passion, commitment or risk assessment

Entrepreneur: a person willing to take a risk and start a new business by bringing together all the resources necessary for success

3 Identify three characteristics of a successful entrepreneur.

4 Identify three changes that could occur in the business environment.

The role of the entrepreneur

An **entrepreneur** is a person willing to take a risk and start a new business by bringing together all the resources necessary for success. This may be done by:

- producing and selling a new product
- building an existing business in a different way
- extending an existing brand into different markets

To avoid the reasons why a new business might fail it is essential to have particular skills and abilities.

Qualities an entrepreneur is likely to need for success

- Determination, drive and energy.
- Passion, initiative and self-confidence.
- Good leadership — being able to persuade and involve others.
- Good network-forming skills.
- Low fear of failure.
- Good assessor of risk and moderate risk taker.
- Clear goal- and vision-setting.
- Good organisation.
- The ability to determine and focus on market needs and wants.

The role of business enterprise

Business enterprise is essential for starting and then making a business grow. If there is no vision and organising mechanisms, a business will drift and increasingly poor decisions will be taken. Workers will become demotivated, efficiency falls and costs rise, sales become harder to achieve and cash flow becomes less manageable.

New businesses are usually small. Typically small businesses supply 40–70% of the jobs in a country and 20–30% of the wealth created. Many countries therefore encourage new businesses by tax incentives, providing infrastructure and advice and low cost start-up finance or development loans.

Enterprise in the form of new businesses generates:

- new ideas, new products and new ways of working
- the seeds for future growth into large businesses
- competition that ensures markets are efficient and existing firms are not complacent
- employment opportunities and training

Social enterprise

Business enterprise measures risks and rewards. Private enterprise focuses on financial reward. Social enterprise focuses on improving society.

The range and aims of social enterprise

A **social enterprise** is a business that trades for a social or environmental purpose and uses its profit for this, rather than distributing it to the owners. Social enterprises:

- are set up to make a difference to society with a clear social/environmental mission
- gain income from selling goods and services, not from donations
- reinvest profits for their social purpose/impact
- operate in a range of sizes and structures

Examples might include:

- providing employment for drug addicts and recovering addicts
- increasing employment for women
- improving the local environment by clearing litter, and landscaping
- recycling furniture to low income households or making new products from old ones
- providing IT resources to charities and low income households
- providing coffee producers with a fair income and market outlets

Social enterprises have to have a business structure that is different from the normal partnership or joint stock companies because social objectives, the requirement to reinvest the profits and the need to pass on any assets to similar enterprises, have to be written in. Examples include cooperatives, community enterprises and not-for-profit companies. They are found in many countries, often working with development agencies or charities.

Social enterprise: a business that trades for a social or environmental purpose and uses its profit for this, rather than distributing it to the owners.

5 Give three examples of social enterprise.
6 Briefly explain the meaning of triple bottom line.
7 Identify three differences between a profit-making business and a social enterprise.

Triple bottom line

The bottom line of many businesses is to achieve targets related to profit. Social enterprises use targets in relation to all these areas:

- **Economic or financial performance** — costs, revenue, surplus.
- **Social impact** — related to their core objectives.
- **Environmental sustainability** — relating to their effect on the environment in the long term.

Business structure

Businesses have to have a legally recognised formal structure. There are various possibilities linked to business size, finance requirements and the type of product and market.

Economic sectors

Primary, secondary and tertiary sectors

Economic activity can be divided into three sectors, each one with industries of a particular type. Businesses generally operate in one of the following three sectors:

- **Primary sector businesses** are those that deal with the extraction of natural resources so they include farming, forestry, fishing, oil, gas, quarrying and mining. These industries form the first stage in the chain of production.
- **Secondary sector businesses** are those that manufacture products or process raw materials. They turn raw materials and components made from raw materials from the primary sector into semi-finished or finished goods. Examples include manufacture of cars, furniture, buildings and processed food.
- **Tertiary sector businesses** are those that provide a service. No physical product is provided. Examples include banking, insurance, education and travel services.

As economies develop they tend to move from being focused on employment and output in the primary sector to the manufacturing sector then the tertiary sector.

Public and private sectors

Economic activity is carried out by **private sector** businesses that are owned by individuals or **public sector** businesses that are owned and run by the state (local or central government).

Private and public sector businesses often have different objectives, e.g. public sector businesses do not have the objective of maximising profit. They also have different legal structures and financial arrangements.

Private sector: contains businesses that are owned and run by individuals.

Public sector: contains businesses that are owned by the state (local or central government).

Primary sector businesses deal with extracting natural resources, e.g. farming, forestry, fishing, oil, gas, quarrying and mining.

Secondary sector businesses manufacture products or process raw materials, e.g. to produce cars, furniture, buildings, processed food.

Tertiary sector businesses provide a service, e.g. banking, insurance, education, travel.

8 State two examples of businesses from each of the primary and tertiary sectors.
9 State two examples of businesses from each of the public and private sectors.
10 State two ways a public sector business might differ from a business in the private sector.

Private sector legal structures for a business

The factors that influence the choice of a particular legal structure include size, owners' responsibility, financial arrangements, the level of owners' risk and possible sources of finance. The ability to raise finance is a crucial factor. A small firm with one owner will find it harder to raise finance than a large business with a record of sound borrowing. A key factor is the ability of the business to become a complete legal entity, separate from the owners.

Limited liability: the financial liability of the owners of a business is limited to the amount they have invested.

11 Define limited liability.

12 Briefly explain one reason why limited liability is so important when a business has to raise large sums of money through a bank loan.

The importance of limited liability

Limited liability means that the responsibility of the owner of a business for business debts is limited only to the specific amount invested in the business, and does not include all their other assets. This means that an owner cannot lose more than the money invested in the business and is therefore encouraged to invest. It enables shares to be issued and large amounts of money to be raised. It occurs because the business is registered as a separate legal entity, capable of suing and being sued in a court. This also means that possible lenders to the business are more likely to lend, knowing their loan is not dependent on individual persons.

Unlimited liability means that the responsibility of the owner for business debt is not limited to the amount invested so business debts might have to be paid from not just the assets of the business but all the assets of the owner.

Main features of private sector legal structures

Sole trader

A **sole trader** is an individual who owns and runs a business, taking final decisions. A few sole traders are large businesses with many employees, many others have a small number of employees or none. The owner has unlimited liability and few administrative or legal requirements. The business is not a separate legal entity so finishes if the owner dies. Typical examples are small retailers and personal services.

Advantages of being a sole trader

- Cheap, quick and easy to set up.
- Owner controls business and has confidentiality.
- Flexible.

Disadvantages of being a sole trader

- Unlimited liability — might lose house to pay business debts.
- Difficult to raise finance from loans.
- Demands owner be skilled at all aspects of business operation.
- Difficult for owner to be absent from business — no sick leave.

Partnership

A **partnership** is when two or more people own and run a business together. Many countries have a maximum number of partners allowed. There is no requirement for formal documents or agreements, but these are common and set out how much each partner has contributed, what responsibilities they have in running the business and how the partnership may be ended. Partnerships generally have unlimited liability and are not legal entities so individual partners have legal responsibility. Some countries allow some partnerships to have limited liability and be a separate legal entity. In this case, there will be formal procedures to go through. Common examples are in the professions, e.g. medicine, law and architects.

Advantages of a partnership

- Easy and cheap to set up.
- More capital raising ability as more than one person and extra partners can be recruited.
- Possibility of 'sleeping partners' to raise finance.
- Shared responsibility, workload and stress.
- Wider range of skills.

Disadvantages of a partnership

- Unlimited liability restricts ability to raise capital and partners may be forced to use personal assets to pay business debts.
- Slower decision making and less control for individuals.
- Possible arguments about work arrangements and share of profits.
- Partnership finishes if one partner leaves so no continuity.

Limited companies

Private or public limited companies share the following features:

- **Incorporation** — the company is a separate legal entity from the owners and can sue and be sued.
- Ownership is through share issue and can be sold.
- The company continues when shareholders change.
- Limited liability of owners.
- Management is by a **board of directors** elected by the shareholders.
- Setting up requires formal registration, regular filing of accounts and reports open to the public.
- Limited liability and share issue enable large amounts of capital to be raised.

This means that limited companies are more expensive to set up but have access to greater sources of capital, are seen as more secure and continue until wound up or taken over. Generally, private limited companies are smaller than public limited companies.

Private limited company

- Often relatively small family owned businesses.
- Relatively cheap to set up.
- Shares can only be traded privately, not advertised for sale.
- Not all accounts and reports are open to the public.
- Cannot be taken over without agreement of shareholders.

Public limited company (plc)

- Usually large businesses.
- Shares issued for sale publicly to anyone via a stock exchange.
- Expensive to set up.
- Accounts, reports and AGM open to anyone.
- Easier to take over as shares available in open market.
- Huge amounts of capital can be raised via share issue.
- Complex to run, directors separate from shareholders so directors might seek different objectives from shareholders.

Incorporation: occurs when a business is set up as a limited company, meaning it is a separate legal entity and its owners have limited liability.

Board of directors: elected by the shareholders of a company to take decisions about running and managing the business.

Franchise: a smaller business that uses the marketing advantages of a large well-known brand in return for payment.

Franchises

A **franchise** is a smaller business that uses the advantages of a large well-known brand in return for payment. The franchisor often supplies a name, logo, generic marketing and lays down conditions for the product. The franchisee supplies the premises, equipment and staff. Typical examples are McDonald's, The Body Shop, Holiday Inn.

The franchisee gets:

- access to a successful marketing model and product, but this may be restrictive
- low cost starting up but weak negotiating position for further supplies
- cheap resources due to access to economies of scale but could have franchise withdrawn if conditions are not met

The franchisor gets:

- guaranteed regular income, assuming the success of franchises
- access to local knowledge, but brand name could be damaged if a franchise is poorly run
- control over the final product or service, but high cost of monitoring and coordination

Cooperatives

A **cooperative** is a business that is owned and run by its members. Cooperatives may be consumer-based, with members being customers, or produce-based or worker-based with members being workers. Members own and run the business and share in the profits.

An example of a small-scale cooperative may be several people who decide to buy their weekly food together or several people who set up a shop and work in it.

Cooperatives enable their members to:

- achieve economies of scale to lower costs or prices
- control their own business activities
- gain greater power in markets, e.g. farmers wanting control over planting or selling

It is difficult for a cooperative to become a large business but there are examples in many countries. Raising finance on a large scale is not easy and taking decisions can be complex as all the members are entitled to have a say. Cooperatives are often set up as social enterprises.

Cooperative: a business that is owned and run by its members.

Other structures

There are other models for business structure. In the private sector these are often social enterprises and take the form of community enterprises, or not-for-profit companies. In the public sector these may be public corporations or chartered businesses set up by government.

Problems resulting from changing from one legal structure to another

A common progression as a business grows is from sole trader to partnership to private limited company to public limited company. Any change from one legal structure to another involves a change of ownership and management. Sole traders are the only form of structure that can be dissolved without going through administrative and regulatory requirements. These will cost time and money to fulfil. Setting up a new structure will also cost time and money to complete the regulatory requirements.

For businesses with multiple owners, these owners must agree to dissolve the business and set one up with a new structure, and getting this agreement can be difficult. It can also be difficult to find new owners or shareholders for a different structure.

Revision activities

1 Draw up a table showing the advantages and disadvantages of the following types of legal structure:
- private limited company
- public limited company
- franchise
- cooperative

2 Giving reasons, recommend an appropriate legal structure for the following:
- A large transnational corporation setting up a new steel plant in another country.
- Five neighbours who embroider shirts and dresses for sale.
- A group that wishes to set up a wind farm to supply electricity to a village.
- A restaurant owner who wants to expand by taking over two other restaurants and a vegetable supplier.
- A newly qualified hairdresser.
- Six engineers who want to go into business designing bridges.

Size of business

Measurements of business size

Different methods of measuring the size of a business

Methods of measuring business size are shown in Figure 1.

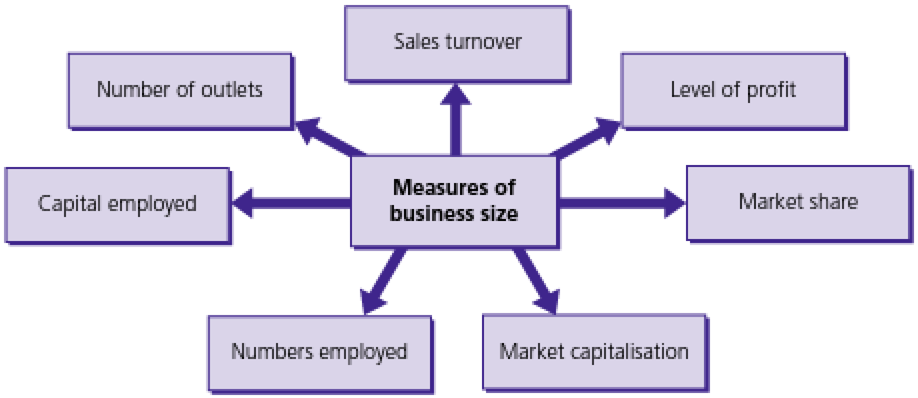


Figure 1 Measures of business size

Difficulties of using these methods

The various methods are not a definitive measure of the size of a business for the following reasons:

- A business using a highly mechanised process will employ fewer workers than a business using labour intensive methods.
- A high value of capital employed might reflect the fact that very expensive equipment is essential for the business to function.
- A business could have a large market share but the market itself might be very small.
- The current market value of a business might be due to a sudden surge or decline in its share value, e.g. some of the dot.com companies.
- Sales turnover can be high due to the sale of only a few but very high value items such as highly specialised computer control mechanisms, e.g. parts being used on space exploration missions.
- A large business might produce a very small profit if market conditions are difficult.

Revision activity

Make a list of three small businesses and three large businesses. Identify the factors that allow you to judge the size of each particular business. Write out your reasons for each judgement.

14 Identify two methods of measuring the size of a business.

15 Explain two problems that might occur when measuring the size of a business.

Significance of small businesses

Advantages and disadvantages of being a small business

Advantages

- Small businesses are often able to respond quickly to market changes because they do not always have highly specialised equipment that is specific to a small range of products.
- It is often the small businesses that are providing a personal and/or specialised service to customers, e.g. hairdressers and local independent shops. They know their customers personally and are able to help and advise them on an individual basis.
- The owner(s) of a small business might be able to retain more power and control over the business than if it grew larger and involved more people in management and/or ownership of the business.
- Employees in a small business might all be known to the owner, leading to a better working relationship that can in turn lead to more loyalty from the employees.

Disadvantages

- Small businesses sometimes find it difficult to obtain bank loans because they have fewer assets to offer as collateral. This can lead to a lack of finance for growth or development of the business.
- A smaller number of employees might mean that the business lacks the opportunity to employ a range of specialist workers.
- A combination of a lack of finance and specialist knowledge could mean that a small business might not have the opportunity to undertake market research and therefore might be unable to maximise its presence in the market. Opportunities might be missed.
- Due to not enjoying economies of scale, the cost of goods and materials might be higher than those paid by larger businesses. This could mean that a small business must charge a higher price and therefore could struggle to remain competitive with larger businesses.
- The business might have to specialise in one product or a small range of products. This could leave it exposed to larger businesses, who can offer more variety.

Strengths and weaknesses of family businesses

Strengths

- The family business is more likely to have members that will be loyal to each other and therefore to the business.
- The family bonds should lead to a stronger working relationship.
- The family employees will all know how to approach one another when discussion is needed.

Weaknesses

- Family feuds might affect the working relationship.
- Family members who are not performing well at work might resent any discipline from another family member. Alternatively there could be a hesitancy to discipline another member of the family. This can cause resentment from other non-family employees.
- Family members are likely to be in the managerial roles and this can prevent the introduction of employees from outside the business who might have expertise that could prove very beneficial to the business.
- The emotional involvement of family members might make some decisions difficult. For example, if one family employee is worthy of promotion another relative might resent this.

The importance of small businesses in the economy

- Small businesses act as suppliers to large businesses.
- Collectively small businesses provide a large number of jobs in an economy.
- Today's small businesses might be the big businesses of the future.

The role of small businesses in some industries

- Small businesses are often a crucial part of the supply chain, e.g. small manufacturers supplying various car parts to a large car manufacturer.
- In some industries small businesses might provide some specialist services for the larger business, e.g. IT updates and servicing or conflict resolution in the case of industrial unrest.
- Recruitment of staff is often undertaken by small businesses working to meet the needs of the large businesses in many industry situations.

16 Give one advantage and one disadvantage of being a small business.

17 Explain one weakness of family businesses.

18 Explain one reason why a government might encourage the start-up of small businesses.

19 Explain why a business might want to grow internally.

Internal growth

Internal growth means that the business will increase its scale of operation by producing and selling more, by opening new outlets or factories and by employing more workers. Internal growth is often a slower means of growth than external growth but it avoids some of the problems associated with external growth.

Why a business might want to grow internally

- To gain the benefits of economies of scale.
- To increase potential for sales and hopefully profit.
- To become a more influential business in the market and therefore perhaps have more power over the price of the goods/services sold.
- To gain more bargaining power with its suppliers.
- To gain a larger market share and therefore more influence in the market.
- By becoming larger a business might be less vulnerable to takeover by a larger business.
- Internal growth is usually a gradual process and allows management changes to take place at a more leisurely pace.
- Because of the slower rate of growth, internal growth can help a business to avoid the dangers of overtrading.

How a business might grow internally

- The business might actively seek more orders for its products/services.
- More equipment and/or premises might be purchased.
- Finance might be obtained to allow additional premises and equipment to be purchased.
- When more orders and additional production capacity have been secured, the business can increase its scale of production.
- A business might diversify into other products/services as a means of growth allowing it to appeal to a larger range of customers.

Business objectives

Business objectives in the private and public sectors

Business objectives are goals or targets that a business will work towards. The objectives will determine all activities that the various sections of the business undertake.

The nature and importance of business objectives at corporate, departmental and individual levels

All objectives and targets must be SMART:

- **S**pecific in what they want to achieve.
- **M**easurable so that progress or ultimate achievement can be assessed.
- **A**ttainable/agreed so that everyone involved will feel capable of reaching the goal and, hopefully, will be motivated to achieve that aim.
- **R**ealistic because setting unrealistic objectives can demotivate a workforce. It might be that it is the timeframe that must be realistic; some goals will take longer than others. For example, it is likely to take longer to grow a business by 100% than to increase sales by 10%.
- **T**ime-specific — without this element the objective would lack an essential element against which the business success would be assessed. For example, an objective to increase market share by 10% would be meaningless if it was not to be achieved within a stated time, e.g. 3 years.

Typical business objectives

Typical business objectives may be:

- profit related; either to maximise profits or to be profit satisficing
- growth of the business
- to increase market share
- to increase sales revenue
- survival

The nature of objectives set can be influenced by:

- **The size of the business.**
- **The business culture.** Some businesses are risk-takers while others are more cautious.
- **The current economic environment.** Is the economy buoyant or is it in recession?
- **How long the business has been in existence.** New businesses might not have the financial resources to support some objectives. In the early stages of a business its only aim in the short term might be to survive. Once established, its focus might change to increasing sales or market share.
- **Whether the business is in the private or the public sector.** An organisation in the public sector might aim simply to provide more people with better products/services. This is unlikely to be an aim of a profit-seeking business in the private sector.

Objectives can be set at a corporate level, e.g. to increase market share by 10% in 5 years; at a departmental level, e.g. the production department might aim to increase output by at least 10% through increases in efficiency, and an individual might be set short-term targets, e.g. to increase productivity by 10% and achieve zero defects.

Objectives are important to businesses because:

- they provide a focus and a framework for business activity
- they ensure that all departments or divisions within a business are working towards the same ultimate goal

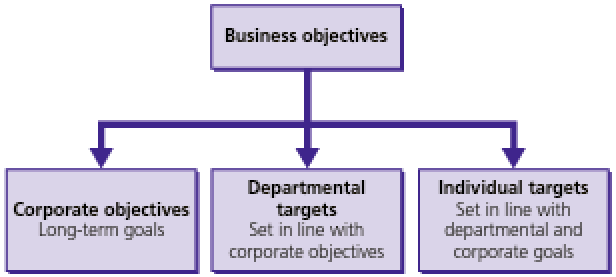


Figure 2 Business objectives

Corporate responsibility as a business objective

Corporate responsibility, also known as **corporate social responsibility**, is increasingly important to businesses because customers are becoming more aware of how businesses behave. Buying decisions can be influenced by the level of corporate responsibility demonstrated by a business.

Businesses can benefit if they can be seen to be behaving in a socially responsible manner, e.g. that they are aware of and working to avoid causing any environmental damage. Also many businesses strive to behave in an ethical manner. For example, a business selling face creams will ensure that the product has not been tested on animals and a business manufacturing car batteries will aim to ensure that it does not cause any pollution or environmental damage. Social responsibility is demonstrated by a business that considers the local community and tries to minimise the impact on local people by aiming to limit the amount of noise and traffic caused by business activities.

Businesses can use a high level of corporate responsibility as a marketing tool. A failure to demonstrate corporate responsibility can lead to adverse publicity that can severely damage the reputation of the business.

Corporate social responsibility: the action, legally required or voluntary, needed for an organisation to act responsibly to all its stakeholders.

23 Briefly explain what is meant by 'corporate social responsibility'.

Mission statement: sets out an organisation's purpose, identity, values and main business aims.

Strategy: an overall plan designed to achieve objectives.

Tactics: the methods a business uses to carry out a strategy.

Relationship between mission statement, objectives, strategy and tactics

A **mission statement** is a public statement of the overall intent of an organisation and is often displayed in a public area of the business. For example, a school or college might have as its mission statement 'To educate the next generation to be highly skilled and meaningful contributors to society'. The objectives or long-term goals would be set to achieve that mission. One objective might be to increase the number of A-level passes by 20% over the next 2 years. A **strategy** would then be devised to help to achieve this. This might involve a change in teaching methods, which might also create the need for more training for the teachers. Alternatively, it could mean that more up-to-date facilities would have to be acquired and this could mean some financial decisions would have to be taken.

The **tactics** involved could be to increase the rate at which students learn. This could be achieved by extending the number of teaching hours or by setting more home study, which students could be encouraged to undertake by the setting of individual objectives.

The same approach is used in business. The corporate objectives are set, then the ways in which the objectives are to be achieved are decided followed by the setting of departmental and/or individual targets that will all contribute to the achievement of the overall objective.

Objectives and business decisions

The different stages of business decision making and the role of objectives

The stages in the decision-making process include:

1. Identify the problem or the goal to be achieved.
2. Collect relevant data.
3. Analyse and evaluate the data in the context of the identified goal/problem.
4. Discuss the advantages and disadvantages of strategies that could be used to achieve the goal.
5. Implement the chosen strategy.
6. Review the effectiveness of the strategy and possibly refine or change the approach used.

Decisions made in a business will be made with the corporate objectives in mind. All decisions must contribute to the achievement of the overall business objective. For example, businesses must decide what resources are needed and where.

How objectives might change over time

- Business circumstances change and so does the economic environment in which businesses operate. This can cause a business to change its corporate objective of increasing market share to focusing on survival in the short term.
- A new competitor might arrive in the industry or the existing competitors might begin to be more aggressive. A business might change its objective from increasing market share by 10% to merely maintaining market share in the face of the increased competition.

Translation of objectives into targets and budgets

Business objectives are usually achieved in stages. These stages are the basis of shorter-term targets that must be achieved if the business objective is to be reached. The targets can be departmental or set for an individual employee.

The business objective will have an overall budget, which will then be divided into smaller budgets that are allocated to each department or division. The size of the budget will be determined by the requirements placed on each department. If a department is expected to increase its output and/or its contribution to the overall business objective, then it is likely that the budget for that department will be increased.

24 Briefly explain how ethics might influence the customers of a business.

Expert tip

When answering a question about ethics do not restrict your answer to discussing pollution. Ethical and environmental issues are connected but can require some different content from you in your answers.

Revision activity

Consider any business that you are familiar with and the extent to which it can be seen to be behaving in an ethical manner. Make a list of the factors that might determine whether or not it is an ethical business.

Ethics: a moral guide to business behaviour. Ethics consider what is morally acceptable behaviour rather than what is legal.

The communication of objectives and their likely impact on the workforce

Objectives are usually communicated to the workforce through the agreed channels of communication within a business. This might be through line managers or via a staff meeting at which all staff are informed of the key aim(s) of the business.

- A workforce is likely to be informed about objectives when those objectives will have an impact either on the way in which they work or on the output they will be expected to produce.
- The objectives might be motivating to the workforce by making them aware of their contribution to the overall aims of the business.
- Being aware of business objectives might give the employees a feeling of team spirit as they will all be working to achieve the same overall goal for the business.
- There could be a demotivating effect on the workforce if the declared aim of the business involves an increase in the use of machinery that could lead to some of the workforce being made redundant.

How ethics may influence business objectives and activities

Ethics are not limited to matters of legality but can be a moral guide to how a business might conduct itself. Ethics can influence business objectives because consumers are becoming increasingly aware of when a business is thought to have behaved in an unethical or immoral way.

Ethics might influence a business objective or activities in the following ways:

- A business seeking to increase its profits might lower its labour costs by employing child labour. As customers could view this as unethical it might deter them from purchasing the product(s).
- Using non-polluting methods of production could be much more expensive than a method that causes substantial pollution. A profit-maximising business might be tempted to use the cheaper option but this would not be ethical.
- Some businesses choose to locate in countries where the laws restricting business activities are very limited or weak. Some might argue that such a move makes good business sense whilst others might argue that it is immoral/unethical because the move was made purely in order to exploit the weaker laws of that country.
- The testing of products on animals is seen as morally unacceptable by some customers. However, a business might be trying to confirm the safety of their products before selling them. Is such a business unethical?

In order for a business to succeed, it must have customers. If modern businesses are judged to be unethical it is likely that they will lose customers. Increased press coverage and the increased use of the internet means that customers are much better informed about the behaviour of businesses now than ever before.

Stakeholders in a business

A **stakeholder** is any individual or group of individuals who have an interest in the activities of a business. These may be internal or external.

Groups involved in business activity

Stakeholders include:

- employees
- shareholders
- customers
- local community
- lenders of finance, e.g. banks
- suppliers
- the government

25 Identify two stakeholders in a business and briefly explain what they would expect to gain from the business activities.

Expert tip

Remember that some stakeholders are internal, e.g. employees, managers and directors, and some are external, e.g. the government, nearby residents and suppliers, and that all of them might be affected by business operations.

26 Briefly explain how stakeholders of a business might be affected by a decision to close a local branch of the business.

Roles, rights and responsibilities of the stakeholders

- **Employees** use their skills and expertise to work in the business and to help the business to achieve its stated aims. They expect to be paid fairly and on time and to be treated in a way that complies with employment law. Employees have a responsibility to the business to work efficiently and not to breach their contract with the business.
- **Shareholders** provide permanent finance for the business in return for a share in the ownership of the business. They expect to receive dividends on the shares they hold if the business makes a profit. The shareholders are expected to use their voting power to appoint the best people to the board of directors and to ensure that the business follows ethical policies.
- **Customers** justify the existence of a business; without customers there is no reason for the business to exist. Customers can expect to receive a product in good condition and that is safe to use. In return customers are expected to pay on time for goods and services received and not to make any false claims against the business. For example, customers should not claim that they had been injured as a result of using a product if that claim was untrue.
- The **local community** allows the business activity to take place and possibly supports the business by providing local goods and services to the main business. The local community will expect a business to carry out its activities in such a way that it is not harmful to the local inhabitants, e.g. noise or water pollution.
- **Lenders**, e.g. banks, provide finance for the business and have a right to expect that repayments will be made by the business in accordance with the lending agreement. The banks will be expected to make funds available to a business once an agreement has been reached. The banks might also be expected to allow only reasonable loan agreements to be made. If a bank lends more than a business can afford to repay, this can result in severe financial difficulty for the business and might result in its closure.
- **Suppliers** are the providers of goods and services required by businesses. They expect to be paid for all goods and services provided and within an agreed time limit. Suppliers are expected to supply goods and services of a required standard or to a standard agreed between the supplier and the purchasing business.
- **Governments** create the legal framework in which businesses operate. They also manage the economy of the country and so can influence the economic environment in which a business operates. Governments expect any business operating in their country to abide by the laws affecting business activity and employment laws.

Impact of business decisions/actions on stakeholders

- **Employees** — a business might decide to switch from labour-intensive production to capital-intensive methods. Employees might resist this change due to some workers fearing that their work will be done by a machine and that they will lose their jobs. Other workers might see this as an opportunity to be trained to use the new equipment and therefore to gain new skills and experience.
- **Shareholders** — an announcement of a large investment in a research and development programme might be received with mixed feelings by shareholders. Some shareholders will see profit being put into the new project rather than being given to them as dividends. Others might take a longer-term view and feel that reduced dividends in the short term could result in even larger profit and dividends in the future if the project is successful.
- **Customers** — the launch of a new product gives customers more choice. However, if the new product replaces an existing one, some customers might be unhappy if they preferred the original product.
- **Local community** — if a large business announces that it intends to relocate to another part of the country, the local community is likely to feel betrayed. Local employment is likely to suffer and the local support businesses will probably lose the business of the larger business. Alternatively, the expansion of a business can put a lot more strain on the local infrastructure and can negatively impact on the lives of the community around the business.
- **Lenders** — the ability of a business to repay loans can be jeopardised if the business decides that it wants to pursue rapid growth. The result might be that if the business grows too fast, it becomes financially unstable. A business might decide to move some of its resources from credit control to what it sees as more profitable activities. This could result in the debts of some customers remaining unpaid and therefore the cash flow of the business could be negatively affected.
- **Suppliers** — a relocation decision might cause suppliers to lose orders, which could in turn mean that they will require fewer workers. The size of the suppliers' businesses might have been in response to the orders placed by the relocating business, and to lose a significant number of orders might cause substantial hardship.
- **Government** — the growth of a business can lead to an increase in the number of people being employed. This helps the government because one of the aims of government is to reduce unemployment. In addition, when a business has growth as an objective there is the hope that this will result in the business becoming more profitable, which means the government should receive more tax revenue from the business.

Why a business needs to be accountable to its stakeholders

Businesses must meet the needs of their stakeholders if they want to continue to have their support.

- **Employees** will seek employment elsewhere if they are not treated fairly and lawfully. This could cause frequent recruitment and selection to take place, which adds to the costs of the business.
- **Shareholders** might sell their shares and purchase shares in other businesses. This might result in competitor businesses being strengthened as they receive additional funds from the issue of new shares.
- **Customers** might cease to purchase products or services from the business if their expectations are not met. Competitors might benefit as customers switch to their products.
- The **local community** might be less tolerant towards the business activities if they think that a business is not considering the impact of its actions on the local inhabitants. For example, if a business does not take care to prevent water pollution, the local community might object strongly to any proposal from the business to increase its scale of activity.
- **Lenders** might refuse further loans or, in the case of an overdraft, might demand that any money owed is repaid immediately. Many businesses need a source of loan funds in order to be able to achieve their objectives.
- **Suppliers** might be more willing to supply goods at short notice if the business has treated them well by giving them regular orders and by paying them on time.
- **Governments** might restrict the activities of a business that has not complied with the legal framework of the country. For example, a business could face large fines if it constantly breaches employment legislation and fails to treat employees according to the laws in force. Businesses that do not comply with legislation are not likely to be considered for government loans and/or grants.

27 Briefly explain why businesses need to satisfy their stakeholders.

How conflict might arise from stakeholders having different aims

Stakeholders might have different expectations of a business. For example:

- Customers want good-quality products at low prices, but if the highest possible profit is to be gained then higher prices might have to be charged. Higher profits will be desired by shareholders because high profit can mean higher dividends being paid to them.
- Shareholders want the business to have large profits but this might be in conflict with the employees who want to be paid higher wages. Higher wages will increase costs but reduce profit.
- The government usually aims to have lower unemployment and will therefore be in conflict with a business that wants to increase its use of machinery and reduce the number of people employed. However, a change in production methods might make the business more profitable and therefore liable to pay more tax to the government.
- If suppliers charge higher prices for their goods, a business will have increased costs, so reducing profits and dividends paid to shareholders.

Revision activity

Make a list of stakeholders in a business and write alongside each one some of the possible causes of conflict between different stakeholder groups.

Revision activity

Make notes on other possible changes in business objectives and which stakeholders might be affected. Note whether the impact is likely to be positive or negative.

How changing business objectives might affect its stakeholders

A change in business objectives can impact on stakeholders, either positively or negatively.

From profit maximisation to increasing market share

The aim of profit maximisation would satisfy the needs of shareholders to receive dividends paid out of profit. On the other hand, a change in objectives to increase market share of the business might result in a reduction in profit due to more money being spent on building an image or perhaps a unique selling point (USP) that might allow a business to gain a stronger position in the market.

From survival to growth

In the early stages of a new business survival might be its only goal. However, as a business becomes more established it might change its aim to that of business growth. This can give some security to the employees and might ultimately produce a larger profit that can be paid to shareholders in the form of dividends. The change of objective might also be beneficial to suppliers because they might expect an increase in the size of orders received as the business achieves its goal of growth.