Cambridge (CIE) IGCSE Business

Your notes

1.3 Enterprise & Business Growth

Contents

Characteristics of Successful Entrepreneurs

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Entrepreneurs Create & set-up a Business

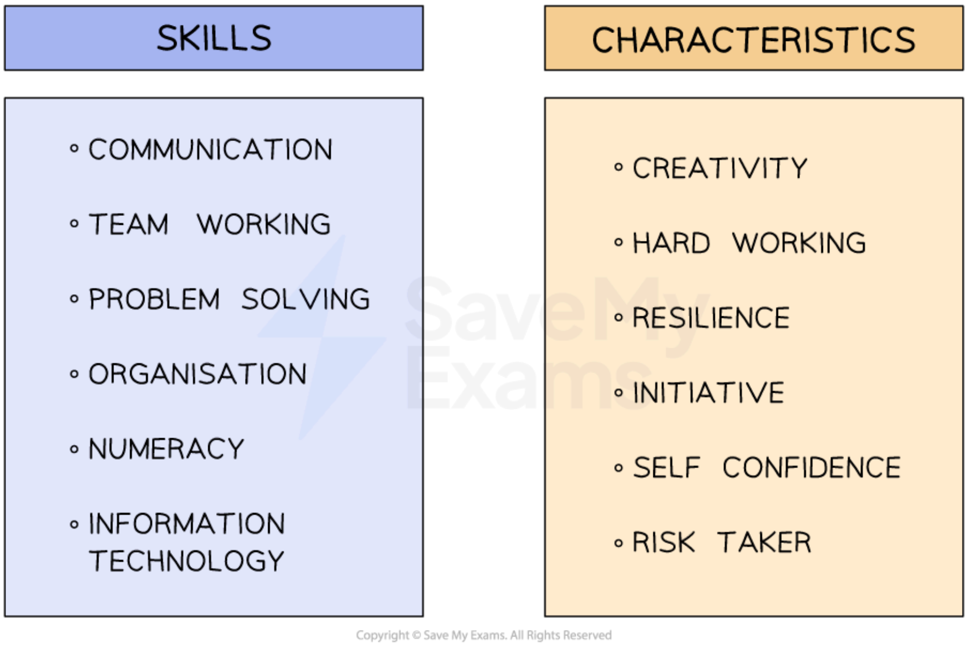
- An entrepreneur is a person who is **willing and able to create a new business idea** or invention and **takes risks** in pursuing success
  - Successful entrepreneurs can identify and pursue opportunities, **create value for customers** and build thriving businesses

What do Entrepreneurs do?

They Organise Resources	They make Business Decisions	They take Risks
▪ An entrepreneur must be able to gather and **coordinate the resources** necessary to start and operate a business ▪ E.g. When Michael Dell started his computer company from his garage, **he had to organise resources** such as space, computers, software tools, and employees, and manage the finances	▪ Entrepreneurs must be able to make decisions that will determine the **success or failure of their business** ▪ E.g. A restaurant owner may need to decide what type of food to serve, where to locate the restaurant, and **what prices to charge**. These decisions require a combination of market research, creativity, and business skill ▪ Making the wrong decisions can lead to wasted resources, lost opportunities, and **ultimately business failure**	▪ Entrepreneurship involves taking risks - financial, personal, or professional ▪ E.g. An entrepreneur may invest their life savings into a new venture or **quit a secure job** to start their own business ▪ They may also take risks by **introducing new products** or entering new markets ▪ These risks can pay off with great rewards, but they can also lead to failure and financial loss

Characteristics & Skills Required by Entrepreneurs

- Entrepreneurs require a **unique set of characteristics and skills**



The skills and characteristics required by entrepreneurs include communication, creativity and resilience

- Successful entrepreneurs tend to be very persuasive in their communication and decisive in their decision-making

Characteristics of Successful Entrepreneurs

Characteristic	Explanation

Risk taker	▪ Entrepreneurs take financial, personal, or professional risks
	▪ An entrepreneur may invest their life savings into a new venture or quit a secure job to start their own business
	  ▪ They may also take risks by introducing new products or entering new markets
	  ▪ These risks can payoff with great rewards, but they can also lead to failure and financial loss

Decision maker	▪ Entrepreneurs must be able to make decisions that will determine the success or failure of their business

	▪ E.g. A restaurant owner needs to decide what type of food to serve, where to locate the restaurant, and what prices to charge ▪ These decisions require a combination of market research, creativity, and business skills ▪ Making the wrong decisions can lead to wasted resources, lost opportunities, and ultimately business failure
Organised	▪ An entrepreneur must be able to gather and coordinate the resources necessary to start and operate a business ▪ E.g. When Michael Dell started his computer company from his garage, he had to organise resources such as space, computers, software tools, employees, and finances

Creative	▪ Developing new solutions to solve existing or emerging problems is a key entrepreneurial role that helps a business stand out from rivals and achieve success
	  ▪ During the 2020 COVID-19 pandemic, many businesses used their creativity to switch production techniques to cater for what the market wanted
	  ▪ E.g Harrogate Gin switched from producing gin to hand sanitiser

Great communicator	▪ Entrepreneurs need to be persuasive communicators ▪ Persuading lenders, investors and customers to support their business is central to achieving financial success

Independent	▪ Starting a business is often the sole responsibility of a single entrepreneur, who will need to be able to solve problems with limited support
	  ▪ E.g. The owner of Gymshark, Ben Francis, started off the company by buying a sewing machine and making gym clothes in his parents garage with a few school friends
	    ▪ This led to the growth of a multi million pound company employing hundreds of people

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Examiner Tips and Tricks

Think about why successful entrepreneurs are important in the country that you are based in. You should be able to explain why governments want to encourage more entrepreneurs to set up in businesses there. Entrepreneurship drives business growth and innovation, and knowing some examples of real life entrepreneurs who have inspired you may help you to remember their skills and qualities (Mark Zuckerberg or Elon Musk?)

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Business Plans & Government Support

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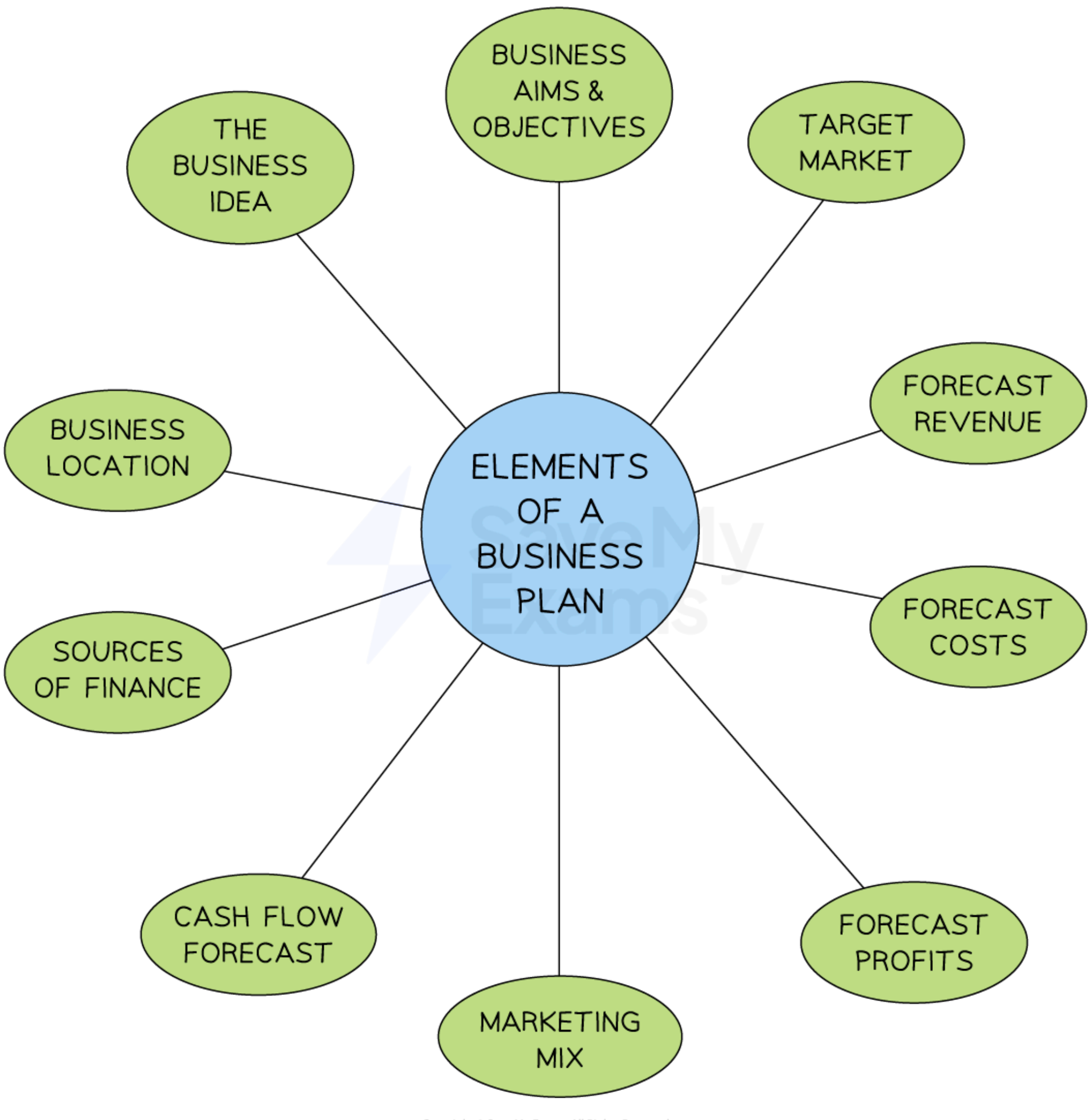
Contents of a Business Plan

- A business plan is a document produced by the owner at start-up, which provides forecasts of items such as sales, costs and cash flow



The main elements included in a business plan, although some differ slightly depending on the nature of the business

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- Producing a business plan forces the owner to think about every aspect of the business **before they start**, which should **reduce the risk** of failure

Elements of a Business Plan

Element	Explanation
The business idea	▪ A **clear explanation of the goods or services** provided by the business which helps to attract investors ▪ This may also include the history of the business idea
Business aims & objectives	▪ What the **business wants to achieve** in the medium and long term ▪ These aims may be both financial and non-financial depending on the business
Target market	▪ This section explains **who the business is aimed at** e.g. age, gender, income and will form part of the firms marketing strategy
Forecast revenue	▪ This section projects **how much income the business plans to make** through sales ▪ Sales Revenue = Price x Quantity Sold ▪ This can help plan for break even levels of output
Forecast costs	▪ Firms need to forecast their **fixed**, **variable** and total costs in order to manage their spending ▪ Some new businesses may have high start up costs, e.g. new stock
Profit forecasts	▪ Investors will be interested to see the firms **profit forecasts** to see whether the **business will have the ability to pay back loaned funds** e.g. bank
Marketing mix	▪ An **explanation of the firms marketing strategy for the product/service** which will outline how the **firm plans to attract customers** ▪ This includes Product, Place, Price and Promotion
Cash-flow forecast	▪ This explains **how the firm plans to manage its inflows and outflows** of cash on a monthly basis in order to avoid liquidity problems

Sources of finance	▪ This section shows t**he sources of finance used to fund the new business** e.g. loans, owners funds or venture capital
Business location	▪ The **location of the business is proposed,** including a map along with an explanation of potential advantages such as transport links or proximity to customers

How Business Plans help Entrepreneurs

- The main aim of producing a business plan is to **reduce the risk** associated with starting a new business and help the owners **raise finance**
- Having carried out research to support the plan, the business will be **well-informed about the potential problems and chance of success**
- A well-written business plan can **help a business obtain finance**
  - Lenders (e.g. banks) and other investors will be able to explore the plan and **make an informed decision** about whether the business is credible and worth the financial risk
  - Investors (e.g. **venture capitalists**) will use the business plan to explore whether there is an opportunity to **increase the value of their investment** and make a worthwhile profit
- A clear action plan **provides direction for the business** and helps lenders and investors have confidence in the future success of the business
- Most high street banks can provide a detailed **template** for business owners to complete when applying for finance

Government Support of Business Start-ups

- Governments often provide support to entrepreneurs
  - This encourages them to set up new businesses or take steps to grow their business
- Reasons for providing **government support** include:
  - Increase the country's level of output to achieve **economic growth**
  - Reduce the level of **unemployment** as new or growing businesses create jobs
  - Improve **choice for consumers** by providing **competition** for existing businesses
- Encourage entrepreneurs to set up **social enterprises** which may support disadvantaged groups or improve communities

How Governments Support Business Start-ups

Support	Explanation
Training and support sessions	▪ **Advice regarding finance, operations and marketing** can often be accessed through local authorities ▪ **Support sessions** offered by business mentors allow entrepreneurs to ask specific questions related to their business

Enterprise zones	▪ Enterprise zones are geographic areas which provide tax breaks and Government support to help businesses grow
	    ▪ Enterprise Zones can provide access to **low-cost premises** and incentives such as reduced **business rates**
	    ▪ They are often linked with **universities** that share expertise and facilities, especially in less economically-developed regions

Finance	▪ Some governments provide low-**interest start-up loans** and **grants** for new or growing businesses that create jobs or invest in training workers

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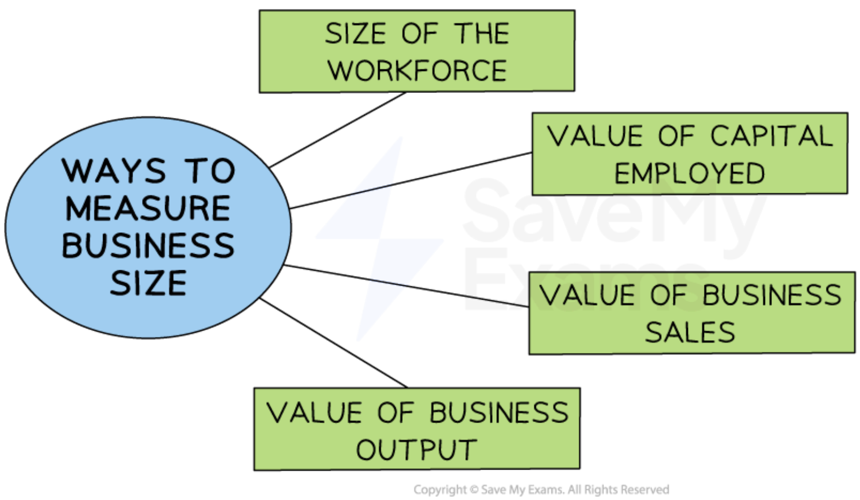
Measuring Business Size

Methods of Measuring Business Size

- A simple way to classify businesses is to consider their **size**



Business size can be measured in several ways, including the size of the workforce, the value of capital employed and the value of sales or output

Size of the workforce

- A measure of how many workers are in the business
- Small and medium-sized businesses (**SME**s) employ less than 250 employees
- Large businesses have 250 or more employees

Value of capital employed by the business

- A measure of all the capital (money, equipment, buildings) that is currently invested in a business

Value of business sales

- The total **sales revenue** achieved during a trading period
- It is calculated using the formula Price x Quantity

Value of business output

- The **financial worth of goods produced,** even though they may not all be sold

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- It is calculated using the formula Total Costs x Quantity

Comparing Business Size

Company	Size of the Workforce	Capital Employed	Value of Output
Futuristic Microchips	▪ 4 Designers ▪ 5 Maintenance staff ▪ 9 Total employees	▪ High tech production line - $100,000	▪ 500 Microchips at $100 = $500,000
Tasty Satsumas	▪ 400 Farm workers ▪ 18 Managers ▪ 418 Total employees	▪ Basic fruit-picking tools ▪ $20,000	▪ 500, 000 oranges at $1= $500,000

- **Futuristic Microchips** is the largest organisation using the measures of number of employees and capital employed
- **Tasty Satsumas is** the same size as **Futuristic Microchips** in terms of the value of output

Stakeholder interest in business size

- **Banks** wish to know how likely any **loans** will be repaid
  - Larger businesses may present less of a lending risk
- **Employees** wish to know how secure their jobs are
  - A growing business is likely to offer **job security**
- **Suppliers** may prefer to sell products to larger businesses
  - Large business are likely to purchase in greater quantities
- **Investors** compare business size to distinguish between investment opportunities
- **Competitors** may set growth objectives or **benchmark** their progress against similar-sized rival businesses
- **Governments** apply different tax rates for small and large businesses

- Larger firms may need careful monitoring to ensure they do not abuse their **market power**

Examiner Tips and Tricks

When comparing business size, it is best to compare like with like, such as weighing up an orange producer with other fruit producers

Limitations of the Methods of Measuring Business size

- Each method of measuring business size has significant limitations

Limitations of Measures of Business Size

Method	Limitations

Size of the workforce	▪ The method of production can influence this metric significantly
	  ▪ **Capital-intensive** businesses produce high levels of output with few employees
	  ▪ **Labour intensive** businesses have many employees that may generate a small volume of output
	▪ The nature of workers' contracts can make this measure unreliable
	  ▪ Some businesses hire many **part-time** workers, while others prefer **full-time** workers
	  ▪ Short-term, **zero hours** or **agency worker** contracts may not be included in workforce measurement

Value of capital employed	▪ Not accurate when **comparing labour-intensive** and **capital intensive** production methods
	  ▪ European manufacturing businesses tend to have high levels of **capital**, **such as robots or advanced machinery**, compared to those located in countries such as Vietnam and Indonesia
	  ▪ **Property values** differ significantly across the world, and even between regions
	    ▪ E.g. The value of property in Singapore is significantly greater than property in mainland China

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Value of sales	▪ Businesses sell very **different products**
	  ▪ Comparing a market stall selling sweets with a retailer of luxury handbags would be unrealistic, as their prices and volumes sold are very different
	▪ Selling **prices vary** between markets
	  ▪ Businesses may sell products to customers in low-income markets at a lower price than in a higher-income market

Value of output	▪ High value output can be produced by businesses with **very few employees** or with **limited capital employed** ▪ E.g. A bespoke jewellery maker may produce only a few expensive items each year ▪ The value of output does not measure how successful a business has been at selling goods produced. If they are **left unsold**, they are a poor measure of business size

Examiner Tips and Tricks

Profit is not a measure of business size. If a multinational like Netflix makes a loss, it does not mean that a sole-trader hairdresser who earns a profit is a larger organisation.

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Types of Business Growth

Reasons for Business Growth

- Many firms start small & will grow into large companies or even **multi-national corporations**
  - E.g. **Amazon** and **Dell** both started in entrepreneurs' garages

Reasons why Businesses Grow

The owner's or manager's desire to **run a large business** & continually seek to grow it	The owner's desire for **higher** levels of **market share** and **profitability**	The desire for **stronger market power** (monopoly) over its customers and suppliers
The desire to **reduce costs by benefiting from lower unit costs** as output increases	Growth provides opportunities for **product diversification**	Larger firms often have **easier access** to finance

Methods of Business Growth

- Business growth can be achieved by growing **organically**, or **inorganically** (mergers and takeovers)

Organic (Internal) growth

- Organic growth is growth that is **driven by internal expansion** using reinvested profits or loans
- It is usually achieved by:
  - Gaining a greater **market share**
  - Product **diversification**
  - Opening new outlets
  - International expansion (new markets)
  - Investing in **new technology**/production machinery

Examples of Organic Growth

Business	Explanation

Apple	▪ **International Expansion (new markets)** Apple expanded into new markets by opening its stores in new countries, such as China and India, and by partnering with telecom providers to sell its products. ▪ This helped them to **organically increase their market share**, sales revenue and profitability
Google	▪ **Product Innovation** Google introduced new products, such as Google Drive and Google Maps, to complement its search engine and advertising businesses ▪ This helped them to organically increase their market penetration, sales revenue and **profitability**
Disney	▪ **Product Diversification** Disney has diversified into several areas, such as theme parks, cruise lines, television networks, and movie studios. ▪ The brand strength has helped them organically increase **market penetration** in each of these markets, resulting in higher sales revenue and profitability

- **Product diversification** opens up new **revenue streams** for a business
  - Firms may spend money on **research and development, or innovation** to existing products to help create a new revenue stream
- Firms will often **grow organically** to the point where they are in a financial position to **integrate** (merge or buy) with others
  - Integration speeds up growth but also creates new challenges

Evaluation of Internal Growth

Advantages	Disadvantages
▪ The **pace of growth** is manageable ▪ **Less risky** as growth is financed by profits and there is existing business expertise in the industry ▪ The management knows & understands every part of the business	▪ The pace of growth can be slow and frustrating ▪ Not necessarily able to benefit from lower unit costs (e.g. bulk purchasing discounts from suppliers) as larger firms would be able to ▪ Access to **finance** may be limited

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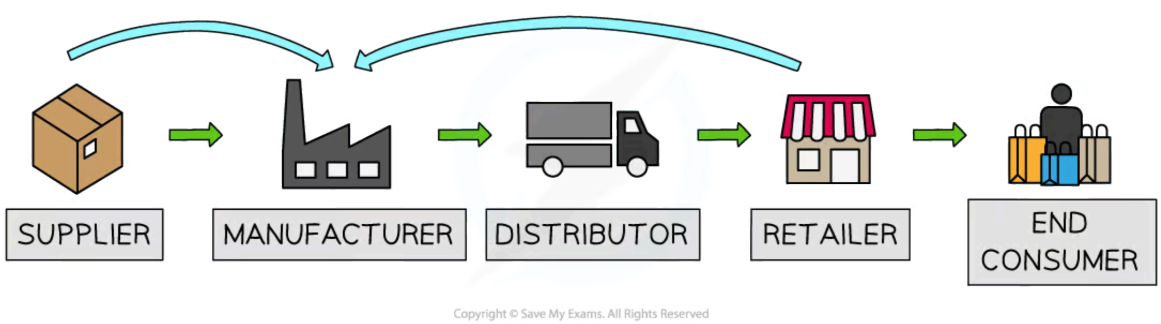
Inorganic (External) growth

- Firms will often grow **organically** to the point where they are in a financial position to **integrate (merge or takeover)** with others
  - Integration in the form of mergers or takeovers results in rapid business growth and is referred to as **external** or **inorganic growth**
- **A merger** occurs when two or more companies combine **to form a new company**
  - The original companies cease to exist and their assets and liabilities are transferred to the newly created entity
- **A takeover** occurs when **one company purchases another company**, often against its will
  - The acquiring company **buys a controlling stake in the target company's shares (>50%)** and gains control of its operations

Vertical integration

- Vertical integration refers to the merger or takeover of **another firm in the supply chain** or different stage of the production process
  - **Forward vertical integration** involves a **merger** with or **takeover** of a firm further forward in the supply chain
    - E.g. A dairy farmer merges with an ice cream manufacturer
  - **Backward vertical integration** involves a merger with or takeover of a firm further backwards in the supply chain
    - E.g. An ice cream retailer takes over an ice cream manufacturer



A firm can grow through forward or backward vertical integration, merging with or taking over another business in the supply chain

Horizontal integration

- Horizontal integration is the merger or takeover of a firm at the same stage of the production process
  - E.g. An ice cream manufacturer merges with another ice cream manufacturer

Evaluation of Types of Growth

Type of Growth	Advantages	Disadvantages
Vertical Integration (Inorganic growth)	▪ Reduces the **cost of production** as middle man profits are eliminated ▪ Lower costs make the firm more **competitive** ▪ Greater control over the supply chain **reduces risk** as access to raw materials is more certain ▪ **Quality** of raw materials can be controlled ▪ Forward integration adds **additional profit** as the profits from the next stage of production are assimilated ▪ Forward integration can increase **brand visibility**	▪ **Diseconomies of scale** occur as costs increase e.g. unnecessary duplication of management roles ▪ There can be a **culture clash** between the two firms that have merged ▪ Possibly **little expertise** in running the new firm results in **inefficiencies** ▪ The price paid for the new firm may take a long time to recoup
Horizontal Integration (Inorganic growth)	▪ Rapid increase of **market share** ▪ Reductions in the cost per unit due to **economies of scale** ▪ Reduces competition ▪ Existing knowledge of the industry means the merger is more likely to be successful ▪ Firm may gain new **knowledge or expertise**	▪ **Diseconomies of scale** may occur as costs increase e.g. unnecessary duplication of management roles ▪ There can be a **culture clash** between the two firms that have merged

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Overcoming Business Growth Issues

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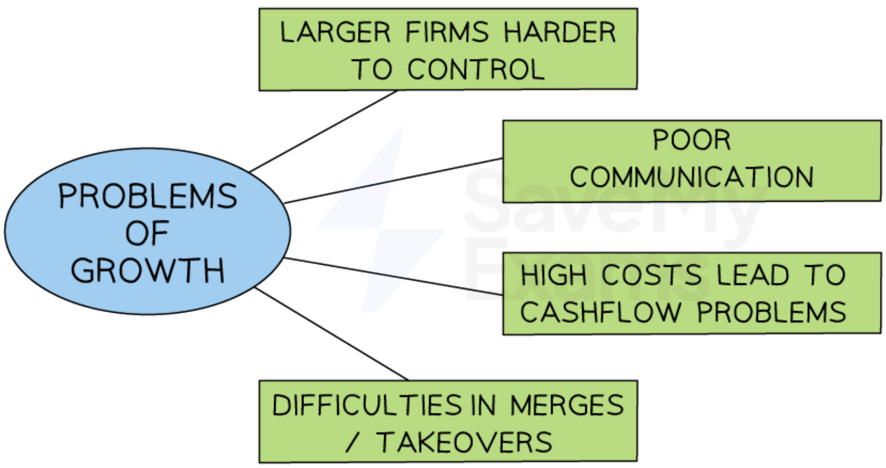
Problems Caused by Business Growth

- In some cases, growing the size of a business can fail to improve its **profitability** and can lead to **cash flow** and coordination problems



Businesses are often faced with a range of challenges when they grow

Problems and Solutions of Business Growth

Problem	Explanation	Solution
Poor communication	▪ Longer **chains of command** and wider **spans of control** for managers may lead to **slower decision-making times** and inefficiency	▪ **Use the latest communication technologies,** such as instant video calls, to improve communication between managers and workers ▪ **Decentralisation** may help to delegate decision-making
Larger firms are often harder to control	▪ As a business grows in size, it can experience **diseconomies of scale** such as poor co-ordination of resources	▪ Operate as a series of **smaller units** which allows local or **functional area** managers to have more control ▪ Increase **delegation** in order to **empower** workers and get jobs

		done more quickly
High costs and cashflow problems	▪ Expansion can be **very expensive** as it may involve developing a new product range or buying a new factory ▪ **High costs in the short/medium term** means the business may need additional finance to avoid cashflow problems	▪ **Grow slowly** using profits rather than loans to fund gradual and less risky expansion ▪ **Manage cash flow** carefully, making use of retained profits and short-term borrowing to counter cash flow shortfalls
Difficulties of mergers and acquisitions	▪ A **culture clash** may occur if a merger or acquisition takes place between two different firms due to different management styles	▪ Ensure good communication so employees are less likely to be resistant to change ▪ Take time to carefully negotiate and plan mergers/acquisitions to reduce 'teething problems'

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Reasons for Businesses to Remain Small

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Why Some Businesses Remain Small

- Some entrepreneurs choose for their business to remain small
  - In 2021, 98.9% of businesses in the European Union (EU) were classified as **small firms** with less than 49 employees
  - Small businesses **dominate some industries**, such as hair and beauty, home improvement and childcare services

Reasons why Small Firms Exist

They offer a **personalised service** and focus on building relationships with customers (excellent customer service)	They are unable to **access external finance** for expansion	They provide a product that is in a **niche market** - small market size but potential for **high profits**
By remaining small they are able to **respond quickly** to changing customer needs/preferences	Rapid growth can cause **diseconomies of scale** which can be avoided by remaining small	Small **business owner's goal is** (**satisficing**) rather than profit maximisation

- While developments in technology often benefit large businesses, some can work to the advantage of small firms
- The Internet offers **low cost access** to market for many firms
  - **Social media** allows even the smallest business to achieve an online presence and target specific groups of customers
  - Online storefronts such as **Amazon Marketplace**, **Etsy** and **Ebay** provide low-cost distribution options

Evaluation of Remaining Small

Advantages	Disadvantages
Small firms often provide **highly customised** or **unique** goods/services which are sold profitably in small quantities at high prices e.g. pet grooming in the customer's home	Small firms are **unlikely to benefit from economies of scale** as the level of output is lower than that of larger firms

▪ **Personal relationships** can be developed with loyal customers which helps to generate word-of-mouth advertising ▪ Smaller firms can respond quickly to **changing market conditions** such as changes in fashions/trends	▪ **Access to finance** such as bank loans or **trade credit** is likely to be limited ▪ **Recruiting/retaining high quality staff** can be challenging as wage & non-wage benefits are less competitive than those offered by bigger firms ▪ Small business owners may **struggle to take holidays/sick leave** as the business relies on their presence to function

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Examiner Tips and Tricks

Do not focus too much on making a judgement about whether businesses are better big or small. Businesses of all sizes can - and do - succeed

It is more important consider whether the size of the business allows it to achieve its overall aim and whether other factors such as its culture and organisational structure contribute to its success

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Why Businesses Fail

Causes of Business Failure

- Business failure is a risk to **both new and established businesses**
  - In 2021, an average of 8% of businesses in EU countries failed
    - The highest failure rate was in **Estonia**, where almost one in four businesses failed
    - The lowest failure rate was in **Greece**, where just over 2% of businesses failed
- **New businesses are often more at risk of failure** than well-established businesses
  - This is often due to **lack of management skills, limited experience** or **cashflow problems** during the initial start-up phase
  - The **volume and variety of tasks** required of new business owners can be **overwhelming**
  - **Market research** is unlikely to be detailed, as small business owners may lack the skills to understand findings and make effective decisions

The Main Reasons why Some Businesses Fail

Financial Factors	Poor Management
▪ A business may be **unable to generate enough revenue** to sustain its operations ▪ **Costs may rise** sharply and eliminate **profit margins** ▪ **Cash shortages** mean that **creditors** cannot be paid what they are owed ▪ **Limited access to finance,** such as loans/**trade credit** can be particularly problematic for start-ups	▪ **Lack of experience** can lead to poor decisions related to product range, pricing or promotional activity ▪ Making decisions based on **hunches** rather than market research ▪ **Ineffective coordination** and **planning** of business operations, such as stock purchasing or staffing, can increase costs
External Factors	**Overtrading**
▪ Ineffective or **delayed response** to new technology, powerful new competitors and major economic change	▪ This occurs when a **business expands too quickly** ▪ **Poor coordination and planning** of growth can lead to **diseconomies of scale**, which increases

▪ Changes in **laws** or **taxation** can increase pressure on businesses to make difficult choices	costs

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Examiner Tips and Tricks

It is worth remembering that making losses does NOT always mean business failure. In many cases, businesses make little (if any) profit in the early stages of operation. This is because they invest in order to increase sales, which should increase profitability in the long run