1 Business and its environment
This chapter will develop your knowledge, understanding and ability to analyse and evaluate:

- the nature and purpose of business activity
- the concept of “creating value”
- economic activity, the problem of choice and opportunity cost
- the dynamic business environment
- what a business needs to succeed
- why many businesses fail early on
- the qualities an entrepreneur is likely to need for success
- the role of business enterprise in the development of a business and a country
- the range and aims of social enterprises
- triple bottom line – economic (financial), social and environmental targets

### 1.1 Enterprise

#### Introduction

Business activity is around us, everywhere. We pass shops on our way to school, we see lorries delivering products, we see advertisements on TV and in newspapers, and we see people going off to work.

![A bustling town in Zanzibar](image)

All of these activities involve decision-making by owners, managers of businesses, customers and governments. This book is concerned with the decisions that need to be made, the factors that influence these decisions and how the decisions are made.

The best way to understand the contents of the book – and the subject – is to take a keen interest in the business world around you. The shops you pass, the people you know who work, and the products and services you buy can all tell you something about business behaviour. Newspapers and television programmes can be a source of ideas and understanding.

Unlike most other subjects, Business Studies has two key features:

- Understanding can be found in the world around you
- The subject is highly interdependent. This means, for example, that what you learn about finance can have an impact on marketing decisions and other areas of a business.

### Case Study

**Sadie’s new business**

Sadie has worked in a printing business for a number of years. Although she enjoys her job and has developed many specialist printing skills she really wants to work for herself. She is attracted by the idea of having the freedom to do what she wants and being her own boss.

Sadie has some savings. She has seen a small printing business advertised for sale at a price she can afford. She believes she has the right contacts to get customers and the determination to make sure that their demands are met. She thinks she will be able to do this at a cheaper price than the business where she currently works, but she has not done her sums yet.

1. Why does Sadie want to set up her own business?
2. What potential problems might Sadie face in starting her business?
3. Why will careful planning be important for Sadie?
4. What is the major risk Sadie is undertaking?
The nature and purpose of business activity

When we eat a bar of chocolate we take many things for granted. We expect the shop to stock the chocolate and to accept our cash when we pay for it. We expect the chocolate to taste nice and be in a proper wrapper. We expect it to be sold at a price we can afford. We probably do not think much beyond that apart from enjoying it when we eat it!

If we analyse the situation we can see the huge range of businesses that are involved in getting that bar of chocolate to you. These include:

- The farmer who grew the cocoa beans
- The farmer who grew the sugar
- The farmer who supplied the milk
- The businesses that supplied the other ingredients
- The transport companies and shipping agents involved in transporting the cocoa, sugar, milk and other ingredients to the factory. This may have involved lorries, ships and aeroplanes
- The insurance companies that insured the shipments
- The business that owns the chocolate factory
- The businesses that supplied the machinery to the chocolate factory
- The businesses that supply other products and services to the chocolate factory, including telephones, gas, electricity, water etc.
- The businesses that marketed the chocolate
- The television stations, magazines and newspapers that carried advertisements for the chocolate
- The wholesale businesses that supplied the shops
- The businesses that transported the chocolate to the shops
- The shop where you bought the chocolate
- The banks that provided finance and other services to all of the businesses mentioned above.

And all of this for one bar of chocolate!

So, what does a business do?

If you examine all of the examples above, the businesses carry out a very wide and diverse range of tasks. However, one thing is common to all of them:

They all use resources of one sort or another to meet the needs and wants of customers.

These customers could be other businesses (the chocolate manufacturer buys cocoa from the farmer or wholesaler) or end customers like you or me who actually eat (consume) the chocolate.
Businesses identify what their customers need and then set about meeting their customers’ needs with whatever resources they have available.

Most of what happens involves businesses buying from other businesses. What the businesses buy includes, in this instance, raw materials (cocoa), finished products (bars of chocolate) and services (such as insurance and banking). Customers who buy from one business and are suppliers to another business are called intermediate customers, they buy both capital goods (machinery, equipment etc.) and intermediate goods and services (raw materials, components etc.). You, the end customer, only come in at the last stage when you buy the product. You are the “end customer”, often known as the “final consumer”, and you buy both final goods and services.

To make the products or supply the services businesses need resources. The resources available to a business need to be identified. Each of the businesses mentioned above need the following to function:

- **Intermediate goods and services**: The farmer needs diesel for the tractor, the chocolate factory needs cocoa to make the chocolate, and the shop needs chocolate bars to sell.

- **Capital goods: machinery, equipment, land or premises**: The farmer needs a tractor and land, the chocolate manufacturer needs a factory and chocolate-making equipment, the shop needs premises, counters and displays. Note that in many Economics textbooks, land is treated as a separate input and includes natural resources.

- **People**: The farmer needs someone to drive the tractor, the chocolate factory needs to employ people to work in the factory, the shop needs someone to serve you and, finally, the shop needs an end customer.

- **Enterprise**: The farm, the chocolate factory and the shop each need owners who take all the risks and make all the decisions.

The other essential item that each of these businesses needs is money:

- To pay for the raw materials and other inputs such as wages
- To buy the necessary machinery, property and so on
- To make all of the risk-taking and decision-making worthwhile for the owner
- As a reward for all the work done.

**Key terms**

- **Capital goods**: the machinery and equipment used to produce products and services.
- **Intermediate goods and services**: the products and services bought by a business to be used in producing its own products and services or to be sold to another business.
- **Customer**: the person/organisation that buys products or services. When this is the final person/organisation in a chain it is also known as the consumer.
- **Final goods and services**, also known as consumer goods and services: the products and services sold to the general public, the end customer.
The concept of “creating value”

Continuing with the chocolate case study, the transformation from cocoa bean to chocolate bar involves many stages and many businesses, all helping to convert the cocoa bean into chocolate.

You might buy a bar of chocolate for $3 but you would not buy a cocoa bean for $3. Why not?

The bar of chocolate is something you would like to buy and you think is worth $3, but the cocoa bean has little value to you because you want chocolate.

However, if the farmer did not grow the cocoa bean you would not have the chocolate bar.

The simplified process is shown in Figure 1.1.3.

At each stage some work has been done:

- The farmer plants the trees, harvests the beans and sells them to the factory.
- The local factory makes cocoa concentrate. This is more valuable to the factory than the chocolate beans.
- The chocolate factory takes the concentrate and other ingredients and makes the chocolate bar. The chocolate bar is more valuable because it is now something the business can sell to the final customer.
- The transport company delivers the chocolate to the shop, making it even more valuable as it is now in the right place.
- The shop sells you the chocolate bar, which is now at its most valuable as this is what you, the final customer, want.

Figure 1.1.3 Stages in producing a chocolate bar
Each stage of the process takes the product closer to what is required for the “end product”, the product that the end consumer wants: in this case, a bar of chocolate. This is known as creating value or, sometimes, adding value, because the work done at each stage adds value to the inputs of that stage, so at each stage the product is worth more. The created value is measured by comparing the value of the inputs to a good or service with the value of the good or service itself.

So, for example, the chocolate factory takes cocoa concentrate as an input which, together with other inputs, produces chocolate bars. The work done by the chocolate factory creates value. Created value/value added is measured by taking the value of the inputs to a process away from the value of the output.

Economic activity, the problem of choice and opportunity cost

Businesses can only survive and flourish if they meet customers’ needs and wants. These needs will be investigated in later chapters, particularly in Topic 3 Marketing. A business should focus on how to meet customer needs and wants, and businesses know that they cannot meet every customer’s needs or wants. A car manufacturer cannot possibly make cars for everyone in the world.

From the customers’ perspective, the customers’ own wants can never be fully met either at an individual level or on a global level. There simply are not enough resources in the world for everyone to have a new car, a new yacht and a new iPhone. Not only are there insufficient resources to make everything everyone wants, many people do not have the financial resources to buy what they need. Many poor people cannot afford the basic requirements of life: clean water, adequate food and shelter.

Because all our wants and needs cannot be met we all have to make choices. We as customers have to prioritise what we buy, and businesses have to choose what products or services they will provide.

The process of businesses producing and customers buying is known as economic activity. The economic activity of a country is the process of suppliers (businesses) and customers (other businesses and end customers) interrelating to match needs and wants with available resources. In wealthy economies many of the needs and wants can be met; in poorer economies the focus is likely to be on more basic needs and wants.

Key term
Creating value/Adding value: the process of increasing the value or worth of a good or service.

Link
Value added is covered in more detail in AS Level Chapter 4.1 The nature of operations.

Activities
1 Investigate three products you use every day. Describe the stages involved in getting these products to you, the customer.
2 Identify the various stages in making a car. What value added is created at the retail stage?

Key terms
Needs: products and services that are essential to our well-being.
Wants: those products and services we desire but are not essential to us.

Progress questions
4 How does a transport business create value for a packet of tea?
5 How is “value added” measured?
The key point is that all participants in an economy have to make economic choices.

- Businesses have to make decisions about what they will make or what services they will provide. They also have to make choices about the inputs they will buy and use.
- Customers have to decide what products and services they will buy with their limited resources.
- Governments have to decide which services they will provide and what the role of government is in managing the economy.

In economic terms choice is often an “either/or” decision: if I decide to buy the latest iPhone I will not have the money to buy a new pair of trainers; if I buy a new car I will have to go on a cheaper holiday; if a business decides on an expensive marketing campaign it may have to reduce spending elsewhere.

This aspect of choice introduces the concept of opportunity cost, an idea that you will meet throughout Business Studies. In making a decision, other opportunities have been foregone (given up). For example, if a government decides to build a new hospital rather than a new school because it cannot afford to do both, it gains the benefit of improved healthcare but loses (foregoes) the benefit of better education facilities for some children. The benefit foregone from the next “best” alternative opportunity is known as the opportunity cost.

The opportunity cost is the value of the opportunity foregone.

So, for example, if I spend money on an expensive meal rather than a new textbook, the opportunity cost is the lost benefit that I would have got from the book. Of course, balanced against this I do have the benefit of enjoying an expensive meal! The opportunity cost of the government spending money on pensions is that there is less to spend on defence. The opportunity cost of a business deciding to build a new factory is the income that would have been generated had the money spent on the factory been put to some other productive use.

**Progress questions**

6 Define opportunity cost.

7 Identify a decision you have made recently. What was its opportunity cost?

**Key term**

*Opportunity cost*: the value of the next best opportunity that is lost by taking a particular decision.

**Getting it right**

It is often useful to think what the opportunity cost of a particular decision is. But remember, opportunity cost is a concept rather than an actual cost incurred.

**The dynamic business environment**

It may be hard to imagine, but DVDs did not become available until 1995. Prior to that film was recorded onto video cassettes. CDs have only been available since 1982. Before that music was recorded on tape and vinyl disc. Although digital photography was developed in the 1950s, the first professional digital cameras were introduced in 1991 and the first widely available digital cameras were sold in 1995. In the 20 or so years since then, traditional film cameras have virtually
disappeared. Hard disc drives had a maximum capacity of about 10 MB in 1985, 100 MB in 1990, 1 GB in 1995, 10 GB in 2000, 100 GB in 2005 and 1 TB in 2010. Since then revolving hard discs have been replaced by solid-state hard drives (SSDs), capable of much faster data transfers and being smaller than equivalent hard disk drives.

These developments in music, photography and computing give some idea of the rate of technological change throughout the business world. Add to these: changes in fashion; the extraordinary economic events following the US “credit crunch” in 2008; huge economic growth in many Asian and South American countries; rapid growth in the availability of information through the Internet, cellphones and smartphones, and we see a business world that has changed and evolved rapidly over the past ten years. It is difficult to forecast what it will be like in one year’s time let alone what it will be like in five years.

In order to survive, most businesses have to keep up with current thinking or developments. They have to be dynamic.

**What businesses need to succeed**

If you completed the activity you might have started by identifying examples of successful businesses. The examples will, of course, depend on where you live. However, in many countries businesses such as Coca-Cola, McDonald’s, Google, Microsoft, Nestlé, Toyota, Canon and Shell could all appear in the list. When you start exploring why these businesses are successful you might note some similarities but also enormous differences. Some of these businesses are retail services, some manufacture products and some extract minerals. Some employ large numbers of people; some rely on expensive facilities such as oil refineries.

However, the one thing that they all have in common is that they provide something that customers want and are prepared to pay for.

In trying to describe factors for success and failure, it is impossible to come up with models to suit every situation. An approach that works for McDonald’s may not suit a fast-food outlet in China, India or Pakistan. The mass car market that has underpinned Toyota’s success is quite different from the executive car market that is targeted by BMW.

However, even if each business has its own unique approach there are several factors most businesses need to consider:

- Market need for their products or services
- Finance
- Suitable location
- Effective management
- A workforce with appropriate skills
- Good relationships with customers
- The ability to compete with competitors
Entrepreneurial skills including, usually, the desire to make profits

- Luck.

**Why many businesses fail early on**

Many later chapters discuss in detail the various issues in managing businesses. However, it is useful to give a broad idea of why many business ideas do not develop into flourishing concerns.

Many businesses fail in their first year of operation. Some of the reasons may be within the business’s control; other reasons may be beyond its control.

Some examples of problems that could contribute to failure and that are within the control of the business include:

- Weak business idea
- Lack of managerial skills
- Lack of suitable employees
- Lack of sufficient finance
- Lack of entrepreneurial skills
- Poor initial research
- Over ambitious ideas
- Poor decisions.

Some examples of problems outside the control of the business include:

- Anticipated customers do not materialise
- Changes in the business environment affect customers
- Unexpected competition, or changes in the competitors’ behaviour.

These are only typical suggestions at this stage. As you go through your Business Studies course there will be many opportunities to reflect on the reasons why some businesses succeed while many others fail early on.

**The role of the entrepreneur in the development of a business and a country**

All business enterprises started with an idea and, usually, with one person or a small number of people prepared to put the effort in to get the business started. These people are known as entrepreneurs, and they have shown the skills of entrepreneurship which include:

- Having an original idea
- Developing the idea into a feasible business proposition
- Providing finance using their own savings and capital and/or, possibly, persuading others to do so
- Accepting the responsibility of owning the business

**Activity**

Identify a business that has failed in your country. Find out what the main causes were. Were they internal or external? Discuss how the business could have avoided failure.

**Key term**

**Business enterprise**: an organisation set up for the purpose of carrying out business activities.

**Entrepreneur**: a person prepared to take the risk of engaging in a business enterprise.
Recognising the risks involved including the possible risk of failure

Taking the risk.

TV stations around the world have TV programmes that put new entrepreneurs to the test, including *Dragons’ Den* (which is called *Tu Oportunidad* in Spain, *Candidate* in Russia, *Leijonan luola* in Finland) and *The Apprentice* (known as *The Apprentice Africa*, *The Apprentice Asia*, *Big Boss* in Germany and *O Aprendiz* in Brazil) which are both broadcast widely around the world in various forms. These provide an excellent insight into the business decision-making processes and the skills needed to succeed in business. These skills include:

- Innovation: the ability to come up with new ideas, and to see their potential value
- Persistence: the ability to keep trying even when there are problems and a project looks as if it might fail
- Leadership: taking decisions and persuading others of their merit
- Assessing and taking risks: most businesses start up with uncertainties so there is always a degree of risk involved.

Most countries need entrepreneurs. Countries need to grow and develop to meet the needs of the population, and entrepreneurs are often the engine for that growth. Small, new businesses are often more able to recognise needs and to produce innovative solutions. Existing large businesses are often slower to respond as will be seen later on.

Entrepreneurs create new businesses and new businesses can create:

- **Employment**: A major difficulty facing many countries is unemployment, particularly amongst young people. Unemployment can cause social problems, so creating employment may help improve social conditions through reduced unemployment and increased tax revenues to help with social projects. When an entrepreneur starts a new business, they will often not be able to do everything themselves and will employ people to help.

- **Large businesses usually start small**: Tomorrow’s large businesses may be today’s new businesses. Most businesses started from very humble beginnings. As some old, large businesses eventually decline, new businesses will replace them.

- **Economic growth**: Most countries rely on economic growth to provide greater funding for essential services such as education, health and defence. Small businesses are often the first to react to improved economic conditions and provide the “engine” that drives growth.

**Progress questions**

8. Define the term “entrepreneur”.
9. Name three qualities you would expect an entrepreneur to have and explain why you think they are important.
10. Why do entrepreneurs usually have to take risks?