



EDEXCEL INTERNATIONAL GCSE (9–1)

BUSINESS

Student Book

Rob Jones



PEARSON EDEXCEL INTERNATIONAL
GCSE (9–1)

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ABOUT THIS BOOK

This book is written for students following the Pearson Edexcel International GCSE (9–1) Business specification and covers both years of the course.

The course has been structured so that teaching and learning can take place in any order, both in the classroom and in any independent learning. The book contains five units that match the five areas of content in the specification: Business Activity and Influences on Business, People in Business, Business Finance, Marketing and Business Operations.

Each unit is split into multiple chapters to break down content into manageable chunks and to ensure full coverage of the specification.

Each chapter features a mix of learning and activities. Global case studies are embedded throughout to show a range of businesses within the context of the chapter. Summary questions at the end of each chapter help you to put learning into practice.

The content for all five units is applicable for both exam papers. Paper 1 is Investigating small businesses and Paper 2 is investigating large businesses. Knowing how to apply your learning to both of these will be critical for your success in the exam. To help with this, relevant chapters feature a section on how the content applies to both large and small businesses. There are also exam-style questions at the end of each unit and two full practice exam papers at the end of the book.

Learning objectives

Each chapter starts with a list of what you will learn from it. They are carefully tailored to address key assessment objectives central to the course.

Getting started

An introduction to the chapter, letting you think about the concepts you will be introduced to. Questions are designed to stimulate discussion and use of prior knowledge. These can be tackled as individuals, pairs, groups or the whole class.

Activity

Each chapter includes activities to embed understanding through case studies and questions.

246 BUSINESS FINANCE STATEMENT OF FINANCIAL POSITION

30 STATEMENT OF FINANCIAL POSITION

LEARNING OBJECTIVES

- Understand the purpose of statements of financial position
- Understand the main features of statements of financial position: current and non-current assets, current and non-current liabilities and capital employed
- Understand how to interpret a statement of financial position

GETTING STARTED

Businesses keep a record of all the resources they own, such as land, property, machinery, tools, inventory and cash. They also keep a record of all the money they owe to banks, suppliers, the owners and other businesses. At the end of the financial year, a business produces a summary of these financial details. Look at the example below.

CASE STUDY: AZORA DINING FURNITURE

Azora Dining Furniture is a small manufacturer of dining room furniture. It makes wooden tables, chairs and other small items of furniture for customers in the south of Estonia. Table 30.1 shows some financial information for the business at the end of 2015. On the left-hand side, the table shows the value of all the resources owned by Azora, which are called assets. On the right-hand side, the value of liabilities and capital is shown. This is the amount owed to the creditors of the business and the owners of the business respectively.



▲ Furniture making

RESOURCES OWNED BY AZORA (ASSETS)	US\$	OWED BY AZORA (LIABILITIES AND CAPITAL)	US\$
Property	180 000	Share capital	200 000
Tools and equipment	95 000	Bank loan	40 000
Inventory	24 000	Trade payables (trucks overdue)	23 000
Trade receivables (clients)	34 000	Taxation	35 000
Other assets	9 000	Reserves	104 900
Cash	54 000		

▶ Table 30.1 Azora financial information, 31 December 2015

- What is the value of all the assets owned by the business?
- How much money does the business owe to (a) the owners and (b) all other creditors?
- What do you notice about the value of assets and the total amount owed by the business?

Case study

Getting started, Chapter review and Activities are all based around case studies. They are drawn from a range of large and small businesses from around the world and will help you see learning applied to real-world contexts.

BUSINESS FINANCE STATEMENT OF FINANCIAL POSITION 247

WHAT IS A STATEMENT OF FINANCIAL POSITION?

Most businesses produce a statement of financial position at the end of the financial year. A statement of financial position is like a photograph of a firm's financial position at a particular point in time. It provides a summary of a firm's assets, liabilities and capital. It is also commonly known as a balance sheet.

SUBJECT VOCABULARY

statement of financial position summary of a point in time of business assets, liabilities and capital (often called the balance sheet)

assets resources used or owned by a business, such as cash, stock, machinery, tools and equipment

liabilities debts of the business, which provide a source of funds

capital finance provided by the owners of the business

Key point

In a statement of financial position, the value of assets (what a business uses or owns) will equal the value of liabilities and capital (what the business owes). This is because all resources purchased by a business have to be financed from either capital or liabilities. Therefore:

$$\text{Assets} = \text{Liabilities} + \text{Capital}$$

So, if a business has capital of US\$5 million and liabilities of US\$2 million, the value of assets must be US\$7 million (US\$5 million + US\$2 million).

▶ Tesco supermarket

ACTIVITY 1

CASE STUDY: TESCO

Tesco is a large supermarket chain. It operates nearly 7000 stores. In 2016, according to its annual reports and accounts, the value of its assets was US\$3904 million. A significant proportion of this (£1 600 million) was property, plant and equipment. The value of Tesco's liabilities was US\$288 million. US\$171 million of this amount was owed to banks and other financial institutions.



- What is the difference between assets and liabilities? Use examples from this case study.
- Work out the value of capital for Tesco.
- Write a letter to a shareholder explaining what a statement of financial position shows.

FEATURES OF A STATEMENT OF FINANCIAL POSITION

The statement of financial position for Dingwall Building Supplies is shown in Table 30.2. The company operates a large store, which serves builders and other traders in the construction industry. The presentation of these statements may vary between different businesses. For example, the statements of limited companies are slightly different to those of sole traders. The details likely to be found in a statement of financial position are outlined below.

Key point

Easy to understand, core information to take away from sections.

Did you know?
Interesting facts to encourage wider thought and stimulate discussion.

Subject vocabulary and General vocabulary
Useful words and phrases are colour coded within the main text and picked out in the margin with concise and simple definitions. These help understanding of key subject terms and support students whose first language is not English.

Chapter review and Chapter questions
A summary case study and associated questions at the end of each chapter to consolidate your learning.

62 BUSINESS ACTIVITY DECISIONS ON LOCATION

TRADE BLOC
Many countries use trade barriers to control the level of imports into their country. There are a number of reasons for this, which are discussed in Chapter 13. These trade barriers can have an impact on location decisions for businesses. To avoid trade barriers, such as tariffs (a tax on imports which makes them more expensive) a business might decide to locate inside a trade bloc. A trade bloc is a group of countries situated in the same region that join together and enjoy trade free of barriers. An example would be the African Union, a trade bloc that includes almost every African nation outside North Africa. The output of a business located inside a trade bloc will be free from trade barriers when selling its products to any member of that trade bloc. For example, in 2015 it was reported that Chinese solar panel producers were locating factories in countries such as Malaysia, Singapore and Thailand to avoid paying import duties when selling their products to America and the EU. Finally, the government might also use regional policy to influence location. This is discussed in Chapter 12.

SUBJECT VOCABULARY
Trade bloc: group of countries situated in the same region that join together and enjoy trade free of barriers.

DID YOU KNOW?
Japanese car producers set up car plants in Europe and the USA in the 1980s and 1990s partly to avoid trade barriers designed by Europe and the USA to keep Japanese cars out of their markets.

LARGE VS SMALL BUSINESSES
Many small businesses, such as shops, solicitors, taxi operators, accountants and gardening services, are located close to where the owners live. This is because many small businesses serve local markets and the owners are not likely to want to travel very far. However, as businesses grow they are likely to attach an increasing amount of importance to factors such as proximity to labour and materials. Large businesses have to look more aggressively at minimising the costs of land and other resources since they will be using much larger quantities. For example, they may consider locating overseas if resources are cheaper.

MULTIPLE-CHOICE QUESTIONS

- An area of ground that was once used for urban development is called?
 - A Brownfield site
 - B Enterprise zone
 - C Science park
 - D Greenfield site
- Which of the following factors is likely to be most important when choosing a location for a supermarket?
 - A Proximity to suppliers
 - B Low-cost land
 - C Exchange rate
 - D Energy costs
- Which of the following businesses is likely to have the most choice when deciding upon a suitable location to base their operations?
 - A Coal-burning power station
 - B Diamond mine
 - C High street fashion retailer
 - D An online taster service
- Which of the following is a likely reason for a manufacturer to relocate its business?
 - A To provide space for expansion
 - B To set up an online operation
 - C To avoid higher interest payments
 - D To avoid having to market its products

63 BUSINESS ACTIVITY DECISIONS ON LOCATION

CHAPTER REVIEW

GENERAL VOCABULARY
Aesthetically appealing: that makes a place comfortable or easy to live in



▲ Pappas built office block on a greenfield site

CASE STUDY: THE NEW DELHI INSURANCE COMPANY

The New Delhi Insurance Company sells a wide range of insurance policies, such as home, holiday, health and vehicle insurance. The company has expanded very quickly after it established an online service about five years ago. Sales of policies have increased dramatically and there is a need to set up a call centre to provide high quality customer service over the telephone. The New Delhi Insurance Company currently employs 12000 people in offices around India. It hopes to locate the call centre in an urban area where its new recruits have access to a wide range of amenities and leisure facilities such as restaurants, coffee bars, sports clubs and cinemas. This is important because the company will need to attract 2000 well-qualified employees to help staff the call centre. It is important to the company that the new recruits are university educated. They must also be relatively fluent in at least two different native languages.

Two sites have been identified as possible locations for the call centre:

Site A This is a brand new purpose built office block on the outskirts of the city about 3 miles (5 km) from a large residential area. Electronic communication connections are extremely efficient. It is a greenfield site and the government is keen to attract businesses to the area.

Site B This is a city centre site close to all the amenities. The office block is in a fashionable and popular area but the building itself is not modern. It will require some investment to upgrade the facilities. However, transport links to the site are excellent. The main railway station is just two minutes walk away. There is also room for expansion if the company needs more office space in the future.

ADDITIONAL INFORMATION ABOUT THE TWO SITES	SITE A	SITE B
Rent per square foot per month*	US\$1	US\$1.10
Graduate unemployment	8.65%	4.20%
Government support	US\$100,000	None

*Note: The call centre will require 200 sq ft (18.5 m) per person

CHAPTER QUESTIONS

- What is meant by the term greenfield site?
- Determine the monthly rent for each site assuming that the company employs 2000 staff. Governments may try to influence the location of businesses.
- Describe two reasons for this.
- What factors would service providers, like the New Delhi Insurance Company, have to take into account when deciding on a business location? Give two reasons in your analysis.
- Comparing the two sites, which one might be most appropriate for the new call centre?

Large vs small businesses
As one exam paper focuses on large businesses and the other on small businesses, this feature details how the content of the chapter may apply differently to large and small businesses.

Multiple-choice questions
Question 1 in both exam papers features multiple-choice questions. These will help you prepare this section of the exams.

Preparing for your International GCSE Business examination
A full practice exam for both Paper 1 and Paper 2 at the back of the book helps you prepare for the real thing.

Exam practice
These exam-style questions are found at the end of each unit. They are tailored to the Pearson Edexcel specification to allow for practice and development of exam writing technique. They also allow for practice responding to the command words used in the exams.

Skills
Relevant exam questions have been assigned the key skills that you will gain from undertaking them, allowing for a strong focus on particular academic qualities. These transferable skills are highly valued in further study and the workplace.

Assessment objectives
Questions are tagged with the relevant assessment objectives that are being examined.

BUSINESS OPERATIONS EXAM PRACTICE 303

EXAM PRACTICE: 5 BUSINESS OPERATIONS

Abdul Engineering is a small manufacturer of metal frameworks. Much of its work involves making frames for greenhouses used by small farms growing vegetables and fruits. The company is stable but has always struggled to grow. Labour productivity has fallen slightly in the last 12 months and Abdul wonders whether it is time to move away from its traditional labour-intensive production methods.

AO1 Define the term 'labour productivity'. (1)

AO2 State one example of an internal economy of scale. (1)

SKILLS **AO1** Explain one link to the growth of a business. (3)

SKILLS **AO1** Explain one disadvantage to a business of using labour-intensive production. (3)

SKILLS **AO1** Explain one reason why it is important to use resources effectively. (3)

Abdul Engineering has started to receive multiple orders for one of its products. As a result of the multiple orders, Abdul is reviewing the production method used at the factory. Two options are being considered for the future.

Option 1: Continue using job production
Option 2: Switch to batch production

SKILLS **AO2** Justify which one of these two options Abdul Engineering should choose. (6)

AO3
AO4

Total marks for this question = 20

304 BUSINESS EXAMINATION (PAPER 1) PAPER 1 INVESTIGATING SMALL BUSINESSES

PREPARING FOR YOUR INTERNATIONAL GCSE BUSINESS EXAMINATION (PAPER 1)

PAPER 1 INVESTIGATING SMALL BUSINESSES

This complete practice paper will help you prepare for your International GCSE Paper 1 examination.

QUESTION 1

Edison-Johar runs a car valet service in Colombo, Sri Lanka. He provides the service for his friend, Nakula Vinoh. He owns a motor service business that carries out repairs and car servicing. The agreement is that Edison washes and valets every car after Nakula has completed his work. This means that Nakula's customers have their car returned clean and tidy without charge. Since Nakula began offering this 'extra' service, repeat custom has grown significantly.

AO1 (a) Which of the following is a variable cost? (1)

- A Rent
- B Packaging
- C Interest payments
- D Insurance premium

AO1 (b) Which of the following documents is used to outline the tasks, duties and responsibilities associated with a job? (1)

- A Job specification
- B Job application form
- C Job description
- D Curriculum vitae

AO1 (c) Which of the following pricing strategies involves charging a high price when a product is first launched? (1)

- A Penetration pricing
- B Cost-plus pricing
- C Skimming
- D Psychological pricing

AO1 (d) Which of the following is an advantage of job production? (1)

- A Flexibility
- B Low unit costs
- C Low training costs
- D Production is quicker

Nakula pays Edison Rs400 for each car cleaned. During an average month, Edison would expect to clean 300 cars. Edison's business has fixed monthly costs of Rs20000 and variable costs of Rs140 per car.

AO2 (e) What is the average monthly revenue for Edison's business? (1)

- A Rs12000
- B Rs120000
- C Rs80000
- D Rs20000

ASSESSMENT OVERVIEW

The following tables give an overview of the assessment for this course. You should study this information closely to help ensure that you are fully prepared for this course and know exactly what to expect in each part of the assessment.

PAPER 1	PERCENTAGE	MARK	TIME	AVAILABILITY
INVESTIGATING SMALL BUSINESSES Written exam paper Paper code 4BS1/01 Externally set and assessed by Pearson Edexcel Single tier of entry	50%	80	1 hour 30 minutes	June exam series First assessment June 2019
PAPER 2	PERCENTAGE	MARK	TIME	AVAILABILITY
INVESTIGATING LARGE BUSINESSES Written exam paper Paper code 4BS1/02 Externally set and assessed by Pearson Edexcel Single tier of entry	50%	80	1 hour 30 minutes	June exam series First assessment June 2019

ASSESSMENT OBJECTIVES AND WEIGHTINGS

ASSESSMENT OBJECTIVE	DESCRIPTION	% IN INTERNATIONAL GCSE
A01	Recall, select and communicate knowledge and understanding of business terms, concepts and issues	27–28* %
A02	Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts	38–39%
A03	Select, organise and interpret business information from sources to investigate and analyse issues	22–23%
A04	Evaluate business information to make reasoned judgements and draw conclusions	11–12%

* A maximum of 15 per cent of total qualification marks will assess knowledge recall.

RELATIONSHIP OF ASSESSMENT OBJECTIVES TO UNITS

UNIT NUMBER	ASSESSMENT OBJECTIVE			
	A01	A02	A03	A04
PAPER 1	13.7%	19.4%	11.3%	5.6%
PAPER 2	13.7%	19.4%	11.3%	5.6%
TOTAL FOR INTERNATIONAL GCSE	27–28%	38–39%	22–23%	11–12%

ASSESSMENT SUMMARY

PAPER 1	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
INVESTIGATING SMALL BUSINESSES PAPER CODE 4BS1/01	Structure Paper 1 assesses 50% of the total Business qualification. There will be four questions on the paper, each worth 20 marks. Students must answer all questions. The sub-questions are a mixture of multiple-choice, short-answer, data-response and open-ended questions.	The total number of marks available is 80	Questions will test the following Assessment Objectives: AO1 – 13.7% AO2 – 19.4% AO3 – 11.3% AO4 – 5.6%
	Content summary This paper will draw on topics taken from the whole of the subject content. The question scenarios are based on a small business – those with up to 49 employees.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		
PAPER 2	DESCRIPTION	MARKS	ASSESSMENT OBJECTIVES
INVESTIGATING LARGE BUSINESSES PAPER CODE 4BS1/02	Structure Paper 2 assesses 50% of the total Business qualification. There will be four questions on the paper, each worth 20 marks. Students must answer all questions. The sub-questions are a mixture of multiple-choice, short-answer, data-response and open-ended questions.	The total number of marks available is 80	Questions will test the following Assessment Objectives: AO1 – 13.7% AO2 – 19.4% AO3 – 11.3% AO4 – 5.6%
	Content summary This paper will draw on topics taken from the whole of the subject content. The question scenarios are based on a large business – those with more than 250 employees.		
	Assessment This is a single-tier exam paper and all questions cover the full ranges of grades from 9–1. The assessment duration is 1 hour 30 minutes. Calculators may be used in the examination.		



1 BUSINESS ACTIVITY AND INFLUENCES ON BUSINESS

Assessment Objective 1

Recall, select and communicate knowledge and understanding of business terms, concepts and issues

This section looks at the nature of business activity and the types of organisations that conduct business, both domestically and internationally. It also covers some of the key factors that might influence business decision making, such as external factors, the government, exchange rates and interest rates. Finally, the ways in which business performance is measured and the possible causes of business failure are addressed.

Assessment Objective 2

Apply knowledge and understanding using appropriate business terms, concepts, theories and calculations effectively in specific contexts

Assessment Objective 3

Select, organise and interpret business information from sources to investigate and analyse issues

Assessment Objective 4

Evaluate business information to make reasoned judgements and draw conclusions

1 WHAT IS BUSINESS ACTIVITY?

LEARNING OBJECTIVES

- Understand the nature of business activity and the reasons why businesses exist
- Understand the role played by different stakeholders
- Understand that businesses operate in a changing business environment

GETTING STARTED

Some people try to make money by setting up a business. They might do this because they want to work for themselves. Or they think they can make more money than working for someone else. Or perhaps they have been made redundant and cannot find another job. Running a business is hard work but the rewards can be worth it. Look at the example below.



▲ Maintaining and repairing old bicycles is hard work

GENERAL VOCABULARY

tool a piece of equipment that is useful for doing your job

SUBJECT VOCABULARY

premises buildings and land used by a shop or business

CASE STUDY: THE KANDY CYCLE SHOP

In 2015, Tharanga Perera opened a second-hand bicycle shop in the city of Kandy in Sri Lanka. He had always wanted to run his own business because he wanted to be his own boss. He worked for 12 years in a tea factory and saved LKR 100 000. Tharanga had a passion for bicycles and spent a lot of his spare time as a hobby restoring old bicycles and selling them to local people. The shop, located in a Kandy backstreet, had a small garage at the rear where he carried out repairs. Tharanga employed his younger brother as a shop assistant while he spent most of the time repairing, maintaining and restoring old bicycles. Before the shop was opened Tharanga had to:

- obtain a LKR 300 000 loan from his grandmother
- buy some new **tools** and equipment
- find suitable **premises**, ideally with somewhere to carry out repair work
- refurbish the premises
- find a reliable supplier of spare parts for his repair and restoration work
- learn how to keep financial records
- advertise the shop.

Tharanga worked very hard. However, it was worth it because in 2016 the Kandy Cycle Shop made a profit of LKR 900 600. Tharanga thought he might start to sell new bicycles in the future if he could get a bank loan to buy some stock.

In groups, discuss the following:

- 1 Why do you think Tharanga opened a second-hand bicycle shop?
- 2 What are three resources used by Tharanga when setting up his business?
- 3 Why do you think businesses exist?

BUSINESS ACTIVITY

SUBJECT VOCABULARY

business organisation that produces goods and services

organisation group, such as a club or business, that has formed for a particular purpose

goods physical products, such as a mobile phone, a packet of crisps or a pair of shoes

services non-physical products, such as banking, car washing and waste disposal

output amount of goods or work produced by a person, machine or factory

human resources in some businesses, the department that deals with employing, training and helping people

A **business** is an **organisation** that provides **goods** and **services**. The Kandy Cycle Shop example illustrates many features of business activity.

- 1 Business activity produces an **output** – a good or service. Tharanga is selling second-hand bicycles (goods) and offering a repair and maintenance service.
- 2 Goods and services are consumed. Customers buy the second-hand bicycles or consume the repair and maintenance service provided by Tharanga.
- 3 Resources are used. Spare parts (such as tyres, wheels and chains), oil, tools, equipment and electricity are just a few of the resources used by the Kandy Cycle Shop. Money, such as the LKR 300 000 loan from his grandmother and his LKR 100 000 savings, is also a resource. The resources used by businesses are often called the *four factors of production* – these are explained in Chapter 44, pages 368-374.
- 4 A number of business functions may be carried out. Production, marketing, **human resources** and financial control are examples of these functions. Production in the case of the Kandy Cycle Shop involved the sale of second-hand bicycles and a repair and maintenance service. Marketing involved advertising the shop in the local area.
- 5 External factors affect businesses. Things that they cannot control have an impact on businesses, such as government laws, changes in consumer tastes and the actions of competitors. The Kandy Cycle Shop has to compete with similar shops in the area.
- 6 Businesses aim to make a profit. Most people setting up a business do so as they wish to make money for themselves. In this case, the Kandy Cycle Shop made a profit of LKR 900 600 for Tharanga in 2016.

GOODS AND SERVICES

SUBJECT VOCABULARY

consumer goods goods and services sold to ordinary people (consumers) rather than businesses

producer goods goods and services produced by one business for another

Businesses provide a wide range of goods and services. Some are produced for consumers – ordinary people. These are called **consumer goods**. Products sold by one business to another are called **producer goods**. Examples are shown in Table 1.1. Some businesses serve both consumers and producers. For example, the Taj Mahal hotel in Mumbai serves both tourists and business people.

▶ Table 1.1 Consumer and producer goods

CONSUMER GOODS		PRODUCER GOODS	
GOODS	SERVICES	GOODS	SERVICES
Smartphone	Health care	Delivery van	Market research
Magazine	Banking	Office furniture	Insurance
Crisps	Air travel	Tools	Software design
Handbag	Education	Sugar cane	Industrial cleaning
Computer game	Garden design	Tractor	Printing

SATISFYING NEEDS AND WANTS

SUBJECT VOCABULARY

needs basic requirements for human survival

wants people's desires for goods and services

Businesses have to satisfy people's **needs** and **wants**.

Needs are the requirements for human survival. Some are physical such as water, food, warmth, shelter and clothing. If these needs cannot be satisfied humans will die.

SUBJECT VOCABULARY

infinite without limits in space or time

finite having an end or a limit

scarce resources with limited availability

Humans also have other desires. These are called wants and include holidays, a better house, a bigger car, a better education and a cleaner environment. These wants are **infinite**. Most people want more than they already have. It is human nature. Unfortunately, the resources available to businesses are **finite**. This means there is a limited amount. Economists say such resources are **scarce**.

THE PURPOSE OF BUSINESS ACTIVITY

Businesses exist to provide goods and services. However, different types of organisation provide goods and services for different reasons. Each type of organisation has a different purpose.

SUBJECT VOCABULARY

private sector business organisations owned by individuals or groups of individuals

public sector business organisations owned by central or local government

- **Private enterprise:** Most businesses are owned privately by individuals or groups of individuals. They are **private sector** businesses. The objective of a private enterprise is often to make money – a *profit* for the owners. The objectives of private sector businesses are discussed in Chapter 2, pages 11–18.
- **Social enterprise:** Some organisations in the private sector are non-profit making. Organisations, such as charities, pressure groups, clubs and societies exist for reasons other than profit. For example, charities, such as UNICEF, exist to raise money for ‘good’ causes. Clubs and societies, such as youth groups and sports clubs, provide opportunities and facilities for people with common interests. Social enterprises are discussed in Chapter 3, pages 19–26.
- **Public enterprise:** Some goods and services are provided by organisations owned by central or local government. These are public sector organisations. In many countries **public sector** organisations often provide health care, education, mail delivery, policing, the fire service and environmental services. The main purpose of a public enterprise is to provide the goods and services that private enterprise fails to provide adequately. Public enterprises are discussed in more detail in Chapter 5, pages 35–43.

DID YOU KNOW?

In the UK there are over 5.4 million privately owned businesses. Most of these are small (10–49 employees) or medium (50–249 employees) in size, they make up 99% of all businesses.

KEY POINT

Many goods and services provided in the public sector are free at the point of use. They are paid for through tax revenue.

ACTIVITY 1

CASE STUDY: GULF CONFECTIONERY AND BISCUIT CO.

The Gulf Confectionery and Biscuit Co. (LLC) manufactures high quality sweets such as toffees and lollies. It has a factory that employs sophisticated, up-to-date technology and it is committed to the production of high quality products.



▲ Some products produced by the Gulf Confectionery and Biscuit Co.

- 1 Does the Gulf Confectionery and Biscuit Co. supply products that satisfy needs or wants?
- 2 The Gulf Confectionery and Biscuit Co. is a private enterprise. What does this mean?

BUSINESS STAKEHOLDERS

SUBJECT VOCABULARY

stakeholder an individual or group with an interest in the operation of a business

Any individual or group that has an interest in the operation of a business is called a **stakeholder**. Owners have a financial 'stake' in the business. This is because they have invested some of their own money and usually a lot of their time. Some stakeholders, such as employees, rely on the success of a business for the income to meet their needs and wants. Figure 1.1 shows the different business stakeholders.

► Figure 1.1 Business stakeholders



SUBJECT VOCABULARY

entrepreneur person who takes risks and sets up businesses; individual who organises the other factors of production and risks their own money in a business venture

OWNERS

A business belongs to its owners. Many small businesses are owned by individuals, families or small groups of people. These people are often called **entrepreneurs**. They are responsible for setting up and running the business. Larger businesses, such as limited companies (see Chapter 4, pages 27–34), are owned by *shareholders*. Shareholders invest money in a business and get a share of the profit called a dividend.

CUSTOMERS

Customers buy the goods and services that businesses sell. Most customers are consumers who use or 'consume' goods and services. However, some may be other businesses. Customers want good quality products at a fair price. If they do not get them; they will spend their money elsewhere.

EMPLOYEES

Employees work for businesses. They depend on businesses for their salary. However, they have other needs. They will require training so that they can do their jobs properly. They want good working conditions, fair pay and benefits, job security and opportunities for promotion.

GENERAL VOCABULARY

dispute serious argument or disagreement
motivate encourage someone to do something

MANAGERS

Managers help to run most businesses. They are often employed to run the different departments in businesses, such as marketing, production, finance and human resources. Managers have to lead teams, solve problems, make decisions, settle **disputes** and **motivate** workers. Managers are likely to help

plan the direction of the business with its owners. They also have to control resources, such as finance, equipment, time and people. Managers are also accountable to the owners. This means they have to take responsibility if things go wrong.

FINANCIERS

Financiers lend money to a business. They may be banks but could be individuals, such as family members, or private investors, such as *venture capitalists* (see Chapter 25, pages 210–217). Clearly these stakeholders have a financial interest in a business and will be keen for it to do well.

SUPPLIERS

Businesses that provide raw materials, parts, commercial services and utilities, such as electricity and water, to other businesses are called *suppliers*. Relations between businesses and their suppliers must be good because they rely on each other. Businesses want good quality resources at reasonable prices. In return suppliers will require prompt payment and regular orders.

THE LOCAL COMMUNITY

Most businesses are likely to have an impact on the local community. A business may employ a lot of people who live in the local community. If the business does well the local community may benefit. There may be more jobs, more overtime and possibly higher pay. In contrast a business may be criticised by the local community. For example, if the owners of a noisy factory decide to introduce night shifts, there may be complaints from local residents.

THE GOVERNMENT

The government has an interest in all businesses. They provide employment, generate wealth and pay taxes. Taxes from businesses and their employees are used to finance government spending.

THE CHANGING BUSINESS ENVIRONMENT

All businesses operate in a changing business environment. This means that they may be affected by external factors that are likely to change over time. Such factors include the strength of competition, the economic climate, government legislation, population trends, demand patterns, world affairs and social factors.

To survive, businesses must produce goods and services that satisfy people's needs and wants. They must have clear objectives and be aware that the changing environment can bring new opportunities and impose new limitations.

DID YOU KNOW?

In 2008/09 there was a global recession. In some countries the recession lasted for many years. This meant that many businesses had to deal with very difficult trading conditions. Many adapted by freezing wages, closing down unprofitable divisions, reducing staff numbers and improving efficiency.

ACTIVITY 2

CASE STUDY: STAKEHOLDERS

► Different stakeholders in a store



- 1 What is meant by the term business stakeholder?
- 2 Name the two groups of stakeholders in the photograph.
- 3 The goods sold in the store above are bought from suppliers. What are the possible needs of suppliers.

MULTIPLE-CHOICE QUESTIONS

- 1 Which of these products is designed to satisfy a need?
 - A Potato crisps
 - B Cricket bat
 - C Bread
 - D Smartphone
- 2 Which of the following is a business stakeholder?
 - A Lawyer
 - B Tax collector
 - C Customer
 - D Police officer
- 3 Which of the following business activities is a service?
 - A House construction
 - B Dental treatment
 - C Coconut farming
 - D Gold mining
- 4 An example of a producer good is:
 - A Tractor
 - B Newspaper
 - C Package holiday
 - D Meal at a restaurant

CHAPTER REVIEW

GENERAL VOCABULARY

machinery equipment with moving parts that uses power, such as electricity, to do a particular job

► Figure 1.2 JCB earnings before interest, tax, depreciation and amortisation (EBITDA), 2011–14

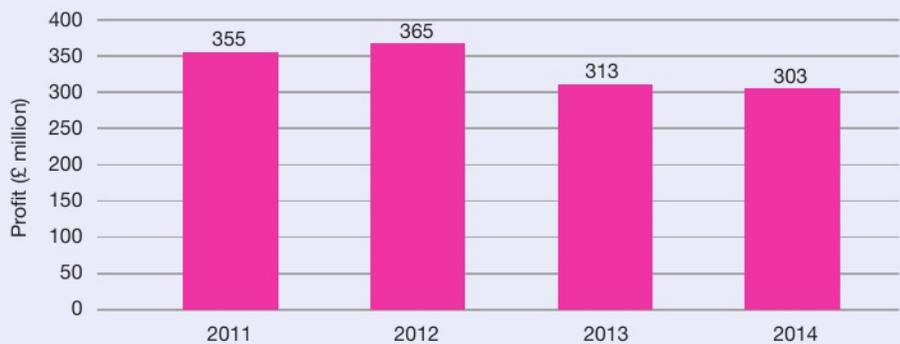
SUBJECT VOCABULARY

EBITDA earnings before interest, tax, depreciation and amortisation

► An example of a machine (digger)

CASE STUDY: JCB

JCB, a private sector business, was formed in 1945 and produced trailers for use on farms. Today, it is one of the top three manufacturers of construction equipment in the world and produces a wide range of **machinery**, such as engines, diggers and forklift trucks. The business employs around 11 000 people in locations over four continents and sells its products through more than 750 dealers worldwide. Figure 1.2 shows the earnings before interest, tax, depreciation and amortisation (EBITDA) made by JCB between 2011 and 2014. During this time, the construction industry has performed poorly in many countries.



CHAPTER QUESTIONS

- 1 JCB makes producer goods. What is meant by the term producer goods?
- 2 What is meant by the term private sector?
- 3 Name two possible stakeholders in JCB.
- 4 Describe the role played by managers in a business such as JCB.
- 5 JCB operates in a changing business environment. What does this mean?
- 6 Assess whether the owners of JCB would be happy with the financial performance of the business between 2011 and 2014.

2 BUSINESS OBJECTIVES

LEARNING OBJECTIVES

- Understand the financial aims and objectives of businesses: survival, sales, profit, market share and financial security
- Understand the non-financial aims and objectives of businesses: social objectives, personal satisfaction, challenge, independence and control
- Understand why business objectives change in response to market conditions, technology, performance, legislation and internal reasons

SUBJECT VOCABULARY

objectives goals or targets set by a business

GETTING STARTED

Businesses exist to produce goods and services for consumers and other businesses. However, the owners of businesses will want to achieve certain **objectives**. Most business owners want to make a profit. They risk their own money when setting up or buying a business and aim to make a financial return. However, there are other objectives that businesses might try to achieve. Look at the example below.

SUBJECT VOCABULARY

executives managers in an organisation or company who help make important decisions

diversify if a business, company or country diversifies, it increases the range of goods or services it produces

CASE STUDY: MICROMAX

In 2015, Micromax overtook Samsung to become India's leading smartphone brand. However, about 12 months later Micromax had lost half of its market share and a number of its top **executives** had left. India is the world's fastest growing market for smartphones. Initially, this encouraged a number of local operators to thrive, with Micromax leading the way. However, energetic competition from Samsung and low-cost Chinese manufacturers has forced Indian suppliers to rethink their strategies. Chinese producers are also squeezing their competitors by joining with e-commerce operators, such as Amazon, to sell their products online.

Micromax also went through a period of change as they employed new executives to help manage its growth. It has been argued that tension between managers resulted in a loss of finance crucial to the development of the company. As its market share continued to fall, Micromax responded by shifting production from China to India. Industry analysts suggested that to survive in the future Micromax needed to **diversify** geographically and develop new products, such as tablets and televisions.

▶ Micromax handsets



- 1 What are two reasons why Micromax is starting to struggle?
- 2 What do you think is the main aim of Micromax at this time?
- 3 What measures might Micromax take in order to achieve this aim?
- 4 In groups, produce a spider diagram to show the different possible objectives a business might have. Present your ideas to the rest of the class.

THE IMPORTANCE OF CLEAR OBJECTIVES

Businesses are more likely to be successful if they set clear objectives. Businesses need to have objectives for the following reasons.

- Employees need something to work towards. Objectives help to motivate people. For example, sales staff might get bonuses if they reach certain sales targets.
- Without objectives owners might not have the motivation needed to keep the business going. Owners might allow their business to 'drift'. This might result in business failure.
- Objectives help to decide where to take a business and what steps are necessary to get there. For example, if a business aims to grow by 10 per cent and its home market is crowded, it may decide that launching products overseas might be the best way to achieve this.
- It is easier to assess the performance of a business if objectives are set. If objectives are achieved it could be argued that the business has performed well.

FINANCIAL OBJECTIVES

In the private sector, where individuals or groups of individuals own businesses, financial objectives are particularly important. This is because most business owners in the private sector want to make money. The main financial aims and objectives are outlined below.

- **Survival:** All businesses will consider survival as important. However, from time to time survival may be the most important objective. For example, when a business first starts trading it may be vulnerable. The owners may lack experience and there may be a shortage of resources. Therefore, an objective for a new business may be to survive in the first 12 months. The survival of a business might also be threatened when trading conditions become difficult or if a strong competitor emerges. In 'Getting started' above, it was suggested that Micromax was starting to struggle owing to

SUBJECT VOCABULARY

financial return monetary return

profit maximisation making as much profit as possible in a given time period

shareholders owners of limited companies

dividends share of the profit paid to shareholders in a company

profit satisficing making enough profit to satisfy the needs of the business owner(s)

competition from Samsung and low-cost Chinese producers. As a result of this its key short-term business objective may have been survival.

- **Profit:** Most businesses aim to make a profit because their owners want a **financial return**. Some businesses try to reach **profit maximisation**. This means they make as much profit as they possibly can. For example, companies, which are owned by **shareholders**, may try to maximise profits. This is because shareholders often put pressure on companies to pay out large **dividends**.
- **Sales:** Some owners want their businesses to grow their sales. This is because businesses with large volumes of sales may enjoy a number of benefits. For example, they:
 - 1 may enjoy lower costs
 - 2 have a larger market share
 - 3 enjoy a higher public profile
 - 4 generate more wealth for the owners.

The growth of a business might also benefit a wide range of stakeholders linked with the business. For example, employees are likely to benefit from the growth of a business because their jobs will be more secure.

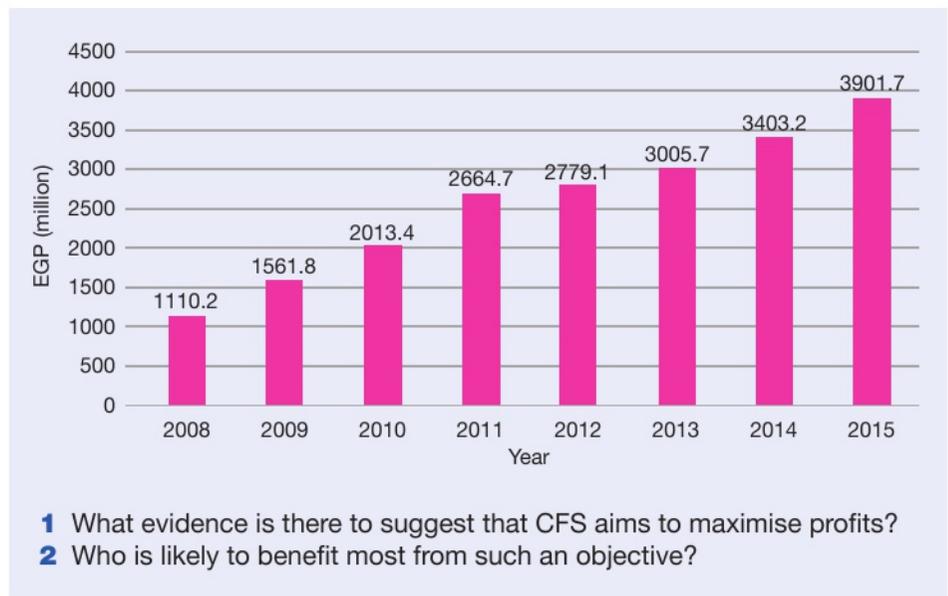
- **Increase market share:** Businesses often want to build a larger market share. They may be able to do this if they can win customers from competitors. Businesses with a large market share may be able to dominate the market. They may be able to charge higher prices, for example. Businesses with a large market share also have a higher profile in the market. This might mean it is easier to launch new products.
- **Financial security:** Some business owners do not aim for profit maximisation. Instead, they might aim to make enough profit to give them financial security. This is sometimes called **profit satisficing**. One reason why some owners do not seek to maximise profits is because they do not want to take on the extra responsibility of expanding their business – which is often required to make more profit. Also, some entrepreneurs run ‘lifestyle’ businesses. This involves running a business that generates enough profit and financial security to provide the flexibility needed to allow a particular lifestyle. This type of business allows owners to spend more time on their other interests or with family. For example, a couple running a busy hotel in the summer might shut down for four months in the winter so that they can go abroad and relax in a warmer climate. However, to do this they first need financial security. This can be an important business aim.

ACTIVITY 1

CASE STUDY: CAIRO FOOD SUPPLIES

Cairo Food Supplies (CFS) make a wide range of canned and packaged food products. It is a large company and employs 4100 people in its factory based near Kirdasah, Egypt. CFS has markets in a number of African states and has been popular with investors for a number of years. This is probably owing to its dividend policy, which is very generous. Figure 2.1 shows the profits made by CFS between 2008 and 2015.

► Figure 2.1 Cairo Food Supplies profits, 2008–15



NON-FINANCIAL OBJECTIVES

Some businesses may have non-financial objectives. These are objectives that are not connected with money. Whether owners have such objectives often depends on the nature of the business. Some business owners might have both financial and non-financial objectives.

SOCIAL OBJECTIVES

- In the public sector, where the government owns businesses, social objectives are important. Social objectives are designed to improve human well-being. In the public sector most businesses aim to provide a public service and the objectives will be linked to quality of service and reducing costs. Examples might include reducing response time by the emergency services or increasing rates of recycling.
- Some businesses operate as social enterprises, not-for-profit organisations, such as charities and cooperatives (see Chapter 3, pages 19–26), and also aim to improve human and environmental well-being. They usually have a clear social or environmental mission. For example, a business may gather used textbooks and distribute them to schoolchildren in developing countries. Their aim might be to help improve the quality of education in these countries.

Finally, in recent years, some businesses have attempted to improve their social responsibility. One way of doing this is to take into account the needs of a wider range of stakeholders, such as customers, the local community and employees. For these businesses, social objectives might include providing employment for local people, reducing pollution or making contributions to the local community, such as visiting schools or sponsoring local events.

PERSONAL SATISFACTION

Many business owners set up a business because they think they will be happier and feel more satisfied in their work environment than when working for an employer. Such owners are likely to enjoy taking risk and seeing their idea succeed. Some owners have developed their hobby into a business. For example, a fitness enthusiast might become a personal trainer or someone who likes baking might start a business making wedding cakes. Investing money in your own business idea and seeing it develop into a successful business is likely to be very satisfying and a matter of great pride.

GENERAL VOCABULARY

negotiation official discussions between the representatives of opposing groups who are trying to reach an agreement, especially in business or politics

outcome result of an action

DID YOU KNOW?

Many businesses set SMART objectives. This means that their objectives should be:

- Specific – stating clearly what is to be achieved
- Measurable – an **outcome** that can be measured in numbers
- Achievable – possible to complete by the people involved
- Realistic – able to be achieved with the resources available
- Time specific – stating a period of time in which to achieve it.

An example of a SMART objective might be for a business to increase its revenue by 8 per cent in the next 12 months.

CHALLENGE

Some people are motivated by challenges and starting a business can be very challenging. To be successful in business people need to be committed, hardworking and multi-skilled. For example, business owners need skills in organisation, financial management, communication, decision making, **negotiation**, IT and people management. Even if a business becomes successful, owners might set new challenges for their business. For example, they may decide to grow by selling overseas or invest in developing new products. Running a business can often provide endless challenges.

INDEPENDENCE AND CONTROL

Some people want to be 'their own boss' – they want to be in control. This is an important non-financial objective for many business owners. These entrepreneurs are driven by the desire to be independent and to take control of their own futures. The freedom to make all the decisions when running a business is very appealing. Some people often dislike being told what to do at work. According to an article and poll by Startups.co.uk, having the independence to make your own decisions is considered the key benefit of being an entrepreneur. Nearly 90 per cent of the people surveyed said this was very important. In practice this independence may be limited: work has to be done; taxes have to be paid; those financing the business, such as a bank giving a loan, need to be satisfied that the business is doing sufficiently well. However, those who own their own business, in general, do have more independence than those who work for an employer.

ACTIVITY 2

CASE STUDY: DOHA AIRLINE MEALS

DAM (Doha Airline Meals) supplies ready-made meals for a number of airlines operating out of Doha airport, Qatar. Omar Hassan set up the business in 2009. Previously, Omar worked for a large hotel working in the kitchen. However, he did not like following instructions and being told what to do all day. He set up in business mainly because he valued independence. He wanted to take complete control of his life and also thought he could improve on some of the 'inflight' meals offered by airlines.

The business was successful right from the start. Omar was very happy being in control and after breaking even in the first year started to make a profit. In 2013, the success attracted interest from a much larger catering company. The company made a very generous offer to buy the business and employ Omar as the managing director. However, Omar declined, he wanted to keep control. This was very important to him.

In 2016, the business made a record profit of US\$1.2 million. Omar said: 'one of the main reasons for our success is setting clear and achievable objectives which employees understand'. One example of an objective set by DAM in 2015 was to increase sales from 2.4 million units to 2.8 million units in 12 months. Omar said: 'I agreed this objective with my sales team. There is no point in setting objectives which are unrealistic and unachievable for staff.'

- 1 Why is independence and control an important objective in this case?
- 2 What is meant by a SMART objective? Use information in this case as an example.
- 3 Why is it important for objectives to be achievable and realistic?



▲ A typical meal served on board an aircraft

WHY MIGHT OBJECTIVES CHANGE AS BUSINESSES EVOLVE?

GENERAL VOCABULARY

evolve to develop and change gradually over a long period of time
sustained continued for a long time
legislation law or set of laws
emissions gas or other substances that are sent into the air

SUBJECT VOCABULARY

automation use of computers and machines instead of people to do a job
economies of scale financial advantages (falling average costs) of producing something in very large quantities

As a business develops and **evolves** over time, its aims and objectives are likely to change. This is usually because businesses have to respond to events or changes in circumstances. Some of the main examples are outlined below.

MARKET CONDITIONS

Businesses operate in dynamic markets. This means they have to deal with regular changes. For example, a new entrant may appear in the market, a rival might introduce a new product or the economy may start to decline. When market conditions change, it may be necessary to set new objectives. For example, if trading becomes difficult as a result of changing market conditions, a profit-seeking business may decide that survival is more important until the market 'settles down'.

TECHNOLOGY

As the pace of technological development increases businesses may have to adjust their objectives. For example, a manufacturer that introduces more **automation** into production may decide to switch its objective to sales growth. This might be necessary to lower costs. A business may be under pressure to sell more in order to exploit **economies of scale** (see Chapter 40 pages 336–343). Alternatively, a business might decide to win a larger share of the market after introducing online selling technology.

PERFORMANCE

The performance of a business is not likely to stay constant. Periods of **sustained** profitability may be interrupted by less successful periods. The performance levels of businesses may have an impact on their objectives. For example, a business that has been growing sales for several years might decide to focus more on profitability. This might be because sales growth has been achieved by lowering prices and the owners are unhappy with the negative impact this has had on profits.

LEGISLATION

New **legislation** might have an impact on the objectives of a business. In recent years, many businesses have become more socially responsible. This might be a reaction to new environmental, employment or consumer legislation. For example, in 2013, EU regulations for the construction industry were tightened to reduce energy use in order to help protect the environment from carbon dioxide **emissions** from the generation of power. This meant that

businesses in the industry had to construct buildings that were more energy efficient. In general, much of the new legislation aimed at businesses is putting pressure on them to consider the needs of a wider range of stakeholders and behave in a more socially responsible way.

INTERNAL REASONS

The reasons outlined above for a business changing its objectives are mainly owing to external factors: things beyond the control of businesses. However, sometimes a business might change its objectives for internal reasons. For example, there may be a change in ownership or a change in the senior management team. In such circumstances the objectives might change. For example, new owners might want to maximise profits so that higher dividends can be paid to shareholders.

SUBJECT VOCABULARY

large business a business that employs more than 250 people

small business a business that employs fewer than 50 people

LARGE VS SMALL BUSINESSES

The objectives of a **large business** and a **small business** may differ. For example, many small businesses may be content to stay small. The people who own them may just want to make enough money to support their families and lifestyles. They may want to avoid the responsibility that may come with growth, for example. Small businesses may also be more interested in some of the non-financial objectives, such as personal satisfaction and independence. It might also be argued that large businesses are more interested in financial objectives. Large businesses may aim to grow even larger and try to maximise profits for their owners. However, most businesses will aim to make some profit – whether they are large or small.

MULTIPLE-CHOICE QUESTIONS

SUBJECT VOCABULARY

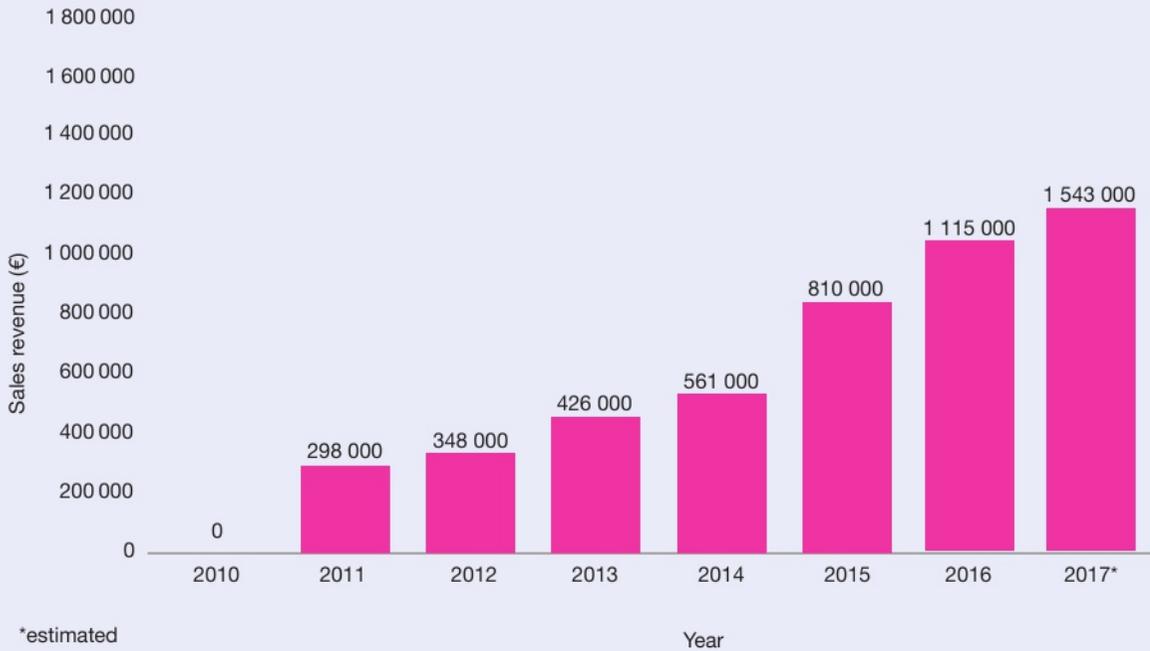
revenue money from the sale of goods and services

- ▶ **1** Which of the following is a non-financial business objective?
- A Increase market share
 - B Independence and control
 - C Profit maximisation
 - D Survival
- ▶ **2** Which of the following is a financial business objective?
- A Improve customer service
 - B Independence and control
 - C Sales growth
 - D Improve social responsibility
- ▶ **3** Which of the following might cause business objectives to change over time?
- A Technological development
 - B A rise in the price of shares
 - C Following the introduction of a new accounting system
 - D A change in weather patterns
- ▶ **4** Which of the following is likely to be an objective of a public sector organisation?
- A Increase profit by 5 per cent in the next financial year
 - B Survival
 - C Increase revenue by 20 per cent over a three-year period
 - D Improve the quality of customer service

CHAPTER REVIEW

CASE STUDY: SUPERSKISWISS.COM

SuperSkiSwiss.com is an online retailer of ski equipment and accessories. It is based in Basel, Switzerland and has recently branched into relatively expensive outdoor fashionwear. It targets skiers and young fashion-conscious consumers. It sells a combination of own-label and branded products. The company has grown rapidly since it was set up in 2000. Its ambitious aim is to be Europe's number one online shopping site for skiers. Figure 2.2 shows the growth in sales revenue between 2010 and 2017. SuperSkiSwiss.com hopes to achieve sales of €3 000 000 by 2020.



▲ Figure 2.2 SuperSkiSwiss.com sales revenue for 2010 to 2017

SuperSkiSwiss.com also claims that it wants to grow in a sustainable way. As a result, for example, the business is committed to the protection of the environment. The biggest environmental impacts from SuperSkiSwiss.com are carbon emissions from the distribution of goods, the running of buildings and waste from packaging. SuperSkiSwiss.com aims to use resources as efficiently as possible by controlling emissions and focusing on the sustainability of packaging. In 2016/17 SuperSkiSwiss.com cut its carbon emissions by 15 per cent. It also reduced its stock and vehicle movements across Europe and saved 11 tonnes of materials by reducing the number of swing tags (product labels) used.

CHAPTER QUESTIONS

- 1 What is meant by a business objective? Use this case as an example.
- 2 Some businesses have non-financial objectives. Name two examples of non-financial business objectives.
- 3 Work out the change in sales revenue between 2010 and 2017.
- 4 Describe one benefit to SuperSkiSwiss.com of sales growth.
- 5 SuperSkiSwiss.com may be concerned about social responsibility. What evidence is there in the case study to support this view?
- 6 How might a company like SuperSkiSwiss.com change its objectives as it evolves? Provide two reasons in your analysis.

3 SOLE TRADERS, PARTNERSHIPS, SOCIAL ENTERPRISES AND FRANCHISES

LEARNING OBJECTIVES

- Understand the features of sole traders, partnerships, social enterprises and franchises
- Understand the advantages and disadvantages of sole traders, partnerships and franchises
- Understand the concepts of risk, ownership, sources of finance and use of profit for the different types of business

GENERAL VOCABULARY

legal status position defined by law

GETTING STARTED

There are several different types of business organisation. They vary according to size, type of ownership and **legal status**. Look at the examples below.

CASE STUDY: MARIANA BELLO

Mariana Bello owns a café in Seville, Spain, which she calls Mariana's. She set up the business in 2012 using €20 000 of her own savings and a €10 000 bank loan. After a slow start, the business picked up when she began to target health conscious customers. She developed a range of drinks from freshly sourced fruit and vegetables and used organic ingredients to make home-made snacks. Mariana now employs six part-time staff and in 2016 made a profit of €46 000.

► Mariana Bello's café





▲ Inside the Hatta Dental and Implant Clinic

CASE STUDY: THE HATTA DENTAL AND IMPLANT CLINIC

The Hatta Dental and Implant Clinic is an established dental practice in Dubai, UAE, which was set up by experienced dentists Khalid Said and Ismail Mansour in 1997. The practice employs seven other people including dental hygienists and administrative staff. It carries out a range of dental work including cosmetic dentistry, such as replacing missing teeth and repairing badly damaged teeth. Khalid specialises in dental implants while Ismail is responsible for a range of routine dental work. When the clinic was set up, both partners each contributed AED 200 000 from personal savings.

- 1 Who owns the businesses in the above two case studies?
- 2 Discuss one advantage and one disadvantage of owning a business with a partner.

Business owners have to take risks.

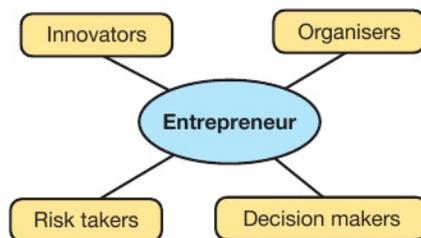
- 3 What risks are taken in the above case studies?
- 4 Discuss in groups whether you would be prepared to take the risk to set up in business. List your reasons for and against and present to the rest of the class.

ENTREPRENEURS

SUBJECT VOCABULARY

innovator someone who introduces changes and new ideas

labour people employed in a business/ used in production



▲ Figure 3.1 Roles of the entrepreneur

People who set up businesses are called entrepreneurs. They are the owners and without them businesses would not exist in the private sector. The roles played by entrepreneurs in business are summarised in Figure 3.1.

- Entrepreneurs are **innovators** because they try to make money out of a business idea. Such ideas might come from spotting a gap in the market, a new invention or market research. However, many people set up a business by copying or adapting what another business does.
- Entrepreneurs are responsible for *organising* other factors of production. They buy or hire resources, such as materials, **labour** and equipment. These resources are used to make their products. Organising involves giving instructions, making arrangements and setting up systems.
- Since entrepreneurs are the owners, they have to make all the key decisions. They may make decisions on how to raise finance, product design, choice of production method, prices, recruitment (see Chapter 18) and wages.
- Entrepreneurs are risk takers. This is because they risk losing any money they put into the business, and possibly more, if it fails. However, if the business is successful, they will be rewarded with profit.

UNINCORPORATED AND INCORPORATED BUSINESSES

SUBJECT VOCABULARY

unincorporated businesses where there is no legal difference between the owner and the business

incorporated business that has a separate legal identity from that of its owners

Businesses vary according to the legal form they take.

- **Unincorporated:** These are businesses where there is no legal distinction between the owner and the business. Everything is carried out in the name of the owner. These businesses tend to be small and owned by one person, or a small group of people.
- **Incorporated:** An incorporated business is one that has a separate legal identity from that of its owners. In other words, the business can sue, be sued, taken over or *liquidated*. Incorporated businesses are often called *limited companies* and the owners are shareholders. This is discussed in Chapter 4, see pages 27–34.

FEATURES OF A SOLE TRADER

SUBJECT VOCABULARY

sole trader or sole proprietor business owned by a single person

unlimited liability owner of a business is personally liable for all business debts

A **sole trader or sole proprietor** is the simplest form of business organisation. It has one owner but can employ any number of people. Sole traders may be involved in a wide range of business activity. In the primary sector, they may be farmers or fishermen. In the secondary sector, they may be small builders or manufacturers. However, most sole traders are found in the tertiary sector. Many are retailers running small shops. Others may offer services such as web design, tutoring, hairdressing, taxi driving, garden maintenance and so on.

Setting up as a sole trader is simple because there are no legal requirements. However, all sole traders have **unlimited liability**. This means that if the business fails a sole trader can lose more money than was originally invested. This is because a sole trader can be forced to use personal wealth to pay off business debts. The advantages and disadvantages of operating as a sole trader are summarised in Table 3.1.

► Table 3.1 Advantages and disadvantages of being a sole trader

ADVANTAGES OF A SOLE TRADER

The owner keeps all the profit.

They are independent – owner has complete control.

It is simple to set up with no legal requirements.

Flexibility – for example, can adapt to change quickly.

Can offer a personal service because they are small.

May qualify for government help.

DISADVANTAGES OF A SOLE TRADER

Have unlimited liability.

May struggle to raise finance – considered too risky by those that lend money.

Independence may be too much of a responsibility.

Long hours and very hard work.

Usually too small to exploit economies of scale.

No continuity – the business dies with the owner.

FEATURES OF A PARTNERSHIP

SUBJECT VOCABULARY

partnership business owned by between 2 and 20 people

deed of partnership binding legal document that states the formal rights of partners

A **partnership** exists when between 2 and 20 people own a business together. The owners will share responsibility for running the business. They also share the profits. Professions such as accountants, doctors, estate agents and solicitors are often partnerships.

There are no legal formalities to complete when a partnership is formed. However, partners may produce a **deed of partnership**. This is a legal document that states partners' rights in the event of a dispute. It states:

- how much capital each partner will contribute
- how profits (and losses) will be shared among the partners
- the procedure for ending the partnership
- how much control each partner has
- rules for taking on new partners.

The advantages and disadvantages of partnerships are summarised in Table 3.2.

GENERAL VOCABULARY

legally binding agreement has been made, and certain actions are now either required or prohibited by law

► Table 3.2 Advantages and disadvantages of partnerships

ADVANTAGES OF PARTNERSHIPS

Easy to set up and run – no legal formalities.

Partners can specialise in their area of expertise.

The job of running a business is shared.

More capital can be raised with more owners.

Financial information is not published.

DISADVANTAGES OF PARTNERSHIPS

Partners have unlimited liability.

Profit has to be shared.

Partners may disagree and fall out.

Any partners' decision is **legally binding** on all.

Partnerships still tend to be small.

LIMITED PARTNERSHIPS

SUBJECT VOCABULARY

limited partnership partnership where some partners contribute capital and enjoy a share of the profit but do not take part in the running of the business

limited liability business owner is only liable for the original amount of money invested in the business

audits official examination of a company's financial records in order to check that they are correct

KEY POINT

In 2000, the law changed in the UK so that limited liability partnerships could be formed. This is where all partners have limited liability. However, to set up a limited liability partnership, the business has to **comply** with a number of legal requirements such as sending annual accounts to the Registrar of Companies (more commonly known as Companies House).

GENERAL VOCABULARY

comply to do what you have to do or are asked to do

It is possible to have a **limited partnership**. This is where some partners provide capital but take no part in the management of the business. Such a partner will have **limited liability** and can only lose the original amount of money invested. This type of partner is called a *sleeping partner*. However, even with a limited partnership there must always be at least one partner with unlimited liability.

ACTIVITY 1

CASE STUDY: KISULI, OKUMA AND OWINO

Kisuli, Okumu and Owino is a firm of chartered accountants based in Mombasa, Kenya. It employs, in addition to the three partners, 16 other staff and provides a range of financial services for local clients. A deed of partnership was drawn up when the business was established in 2010. To raise finance for the business, each partner contributed KES 2 000 000. One of the strengths of the business was that each of the partners was a specialist in a particular field. Michael Kisuli was a corporate tax specialist, Edwin Okumu was an investment analyst and Joseph Owino was in charge of **audits**.



► One of the partners at work

- 1 Why do you think Kisuli, Okumu and Owino drew up a deed of partnership?
- 2 How does this case study illustrate one of the main advantages of partnerships?

FEATURES OF FRANCHISES

SUBJECT VOCABULARY

franchise structure in which a business (the franchisor) allows another operator (the franchisee) to trade under their name
merchandise goods that are being sold

One approach to running a business is to buy a **franchise**. This may suit someone who wants to run a business but does not have their own business idea. Owners of franchises are called *franchisors*. They have developed a successful business and are prepared to allow others, the *franchisees*, to trade under their name. Franchisees pay fees to the franchisor. Examples of some international franchises are McDonald’s, Subway and Avis, the car rental business.

What does the franchisor offer the franchisee?

- A licence to trade under the recognised brand name of the franchisor.
- A start-up package including help, advice and essential equipment, usually including branding materials.
- Training in how to run the business and operate the systems used by the franchise.
- Materials, equipment and support services that are needed to run the business.
- Marketing support that is organised on behalf of all franchisees.
- An exclusive geographical area in which to operate. This means that the business will not face competition from other franchisees in the same franchise group.

In return for these services the franchisee has to pay certain fees.

- A one-off start-up fee.
- An ongoing fee (usually based on sales).
- Contribution to marketing costs.
- Franchisors may make a profit on some of the materials, equipment and **merchandise** supplied to franchisees.

▼ Table 3.3 Advantages and disadvantages to franchisees and franchisors of franchising

The advantages and disadvantages of franchises to both franchisees and franchisors are shown in Table 3.3.

ADVANTAGES TO THE FRANCHISEE	DISADVANTAGES TO THE FRANCHISEE	ADVANTAGES TO THE FRANCHISOR	DISADVANTAGES TO THE FRANCHISOR
Less risk – a tried and tested idea is used. Back-up support is given. Set-up costs are predictable. National marketing may be organised.	Profit is shared with the franchisor. Strict contracts have to be signed. Lack of independence – strict operating rules apply. Can be an expensive way to start a business.	Fast method of growth. Cheaper method of growth. Franchisees take some of the risk. Franchisees more motivated than employees.	Potential profit is shared with franchisee. Poor franchisees may damage brand’s reputation. Franchisees may get merchandise from elsewhere. Cost of support for franchisees may be high.

FEATURES OF SOCIAL ENTERPRISES

SUBJECT VOCABULARY

social enterprise business that aims to improve human or environmental well-being, charities for example

cooperative company, factory or organisation in which all the people working there own an equal share of it

consumer cooperative cooperative that is owned by its customers

retail cooperative cooperative of retail members, who often work together to assert their purchasing power

worker cooperative cooperative that is owned by its employees

charities organisations that give money, goods or help to people who are poor, sick or in need

GENERAL VOCABULARY

accountable responsible for the effects of your actions and willing to explain or be criticised for them

transparent language or information that is clear and easy to understand

Some businesses operate as **social enterprises**. These aim to improve human and environmental well-being rather than make a profit for owners. They are sometimes referred to as not-for-profit or non-profit organisations. Generally, social enterprises:

- have a clear social and/or environmental mission
- generate most of their income through trade or donations
- reinvest most of their profits
- are majority controlled in the interests of the social mission
- are **accountable** and **transparent**.

Social enterprises may take a variety of forms.

Cooperatives usually operate as **consumer cooperatives** or **retail cooperatives**. They are owned and controlled by their members. Members can buy shares which entitle them to elect directors to make key decisions. Any profit made by the cooperative is given to members.

Worker cooperatives are businesses in which its employees share ownership. Examples might be a wine growing or milk producing cooperative. Workers will contribute to production and be involved in decision making, share in the profit and provide some capital when buying a share in the business.

Charities exist to raise money for 'good' causes and draw attention to the needs of disadvantaged groups in society. For example, Age UK is a charity that raises money on behalf of senior citizens. It also raises awareness and comments on issues, such as cold weather payments (payments made to elderly people in the UK for heating during cold weather). Charities rely on donations for their revenue.

They may also organise fundraising events such as cake sales, sponsored activities and selling greetings cards. Some run business ventures such as charity shops.

ACTIVITY 2

CASE STUDY: SAVE THE CHILDREN

Save the Children is a charity that raises money to run world-class programmes to save children's lives and challenge world leaders to keep to their promises to give children a brighter future. In 2016, the charity reached 56 million children in 120 countries. Save the Children raised about US\$2.1bn million in 2016. Figure 3.2 shows its key sources of funds.



► Figure 3.2 Save the Children global income by source of funds

- 1 What are the features of a social enterprise? Use this case as an example.
- 2 How might charities such as Save the Children raise money?

LARGE VS SMALL BUSINESSES

The types of business organisation described in this chapter are most likely to operate as small businesses. In many economies the majority of businesses are sole traders. In certain fields, such as the professions, partnerships are common. However, they are often small. Most franchisees are small businesses but franchisors may be large – McDonald's, for example. Many social enterprises are small but some charities, such as UNICEF and Oxfam, are very large since they have an international presence.

MULTIPLE-CHOICE QUESTIONS

- ▶ 1 Which of the following is an advantage of a sole trader?
 - A Limited liability
 - B More capital can be raised than a partnership
 - C Unlimited liability
 - D Independence for owners

- ▶ 2 Having a clear social and/or environmental mission is a feature of which business structure?
 - A Franchise
 - B Sole trader
 - C Social enterprise
 - D Partnership

- ▶ 3 A fast method of growth is a key advantage for which business structure?
 - A Franchisor
 - B Partnership
 - C Franchisee
 - D Social enterprise

- ▶ 4 Taking risk in business is a key role of which of the following?
 - A Accountant
 - B Entrepreneur
 - C Company director
 - D Marketing manager

CHAPTER REVIEW



▲ A Husse delivery van

CASE STUDY: HUSSE

Husse (pronounced hoo–say) is a Swedish franchising operation established in 1987. It delivers pet products to customers in over 50 countries around the world. Husse has around 1000 franchisees delivering a range of luxury pet food products, accessories, health and cleanliness products for cats and dogs, and care products for horses. It can cost franchisees up to £13900 to obtain a Husse franchise in the UK. Some of the benefits provided by the Husse franchisor (for the £13900 premium package) include:

- 1 a stock of dry food worth £2000 for resale
- 2 additional materials worth £2000 (including items such as a Husse tent, signs for a van, catalogues, two-day in-house training, social media set up and uniforms)
- 3 exclusive territory with 55000 households
- 4 regular money for marketing (in first six months)
- 5 support including a range of advisory services and development manager
- 6 free training, workshops and seminars
- 7 an operational manual.

Husse UK is an associate membership of BFA (British Franchise Association).

CHAPTER QUESTIONS

Franchisees are entrepreneurs.

- 1 What is meant by the term entrepreneur?
- 2 What is meant by the term franchisor?
- 3 What are the four roles of an entrepreneur?

Franchisees are likely to have unlimited liability.

- 4 What is meant by unlimited liability?
- 5 Assess the advantages to a franchisee of taking out a Husse franchise.

4 LIMITED COMPANIES AND MULTINATIONALS

LEARNING OBJECTIVES

- Understand how a limited company is formed
- Understand the features of private limited companies, public limited companies and multinationals
- Understand the advantages and disadvantages of operating as a private limited company and a public limited company
- Understand the ownership, control, sources of finance and use of profits for limited companies

GETTING STARTED

Limited companies have different features to sole traders and partnerships. They have different types of owners and raise capital in different ways. They are also set up and run differently. Look at the examples below.

SUBJECT VOCABULARY

venture capitalists specialist investors (individuals or companies) who provide money for business purposes, often to new businesses

CASE STUDY: QUBIT DIGITAL LTD

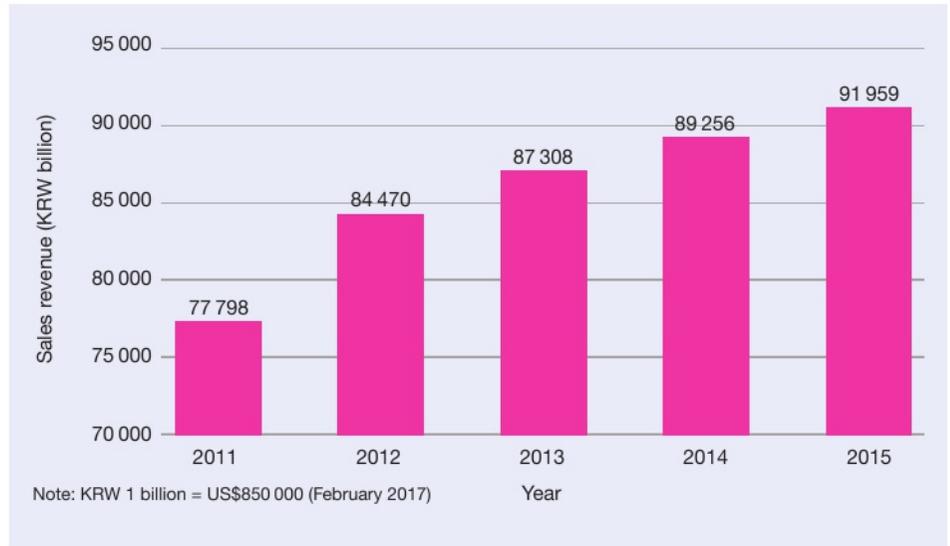
Four ex-Google employees set up Qubit in 2010. Its technology helps retailers get the best out of their websites. For example, its tools track what people look at on web pages and why they leave a website. Some of its high profile customers include Topshop, Emirates and Thomas Cook. Qubit is led by one of the people who originally formed the business, Graham Cooke, and has offices in the USA and Europe. It has raised over £50 million from share sales since it was set up and some of its shareholders include Goldman Sachs and **venture capitalists** Sapphire Ventures and Accel Ventures. In 2016, Qubit employed over 200 people.

CASE STUDY: HYUNDAI LTD

Hyundai is a huge South Korean motor corporation. It is led by Chairman Mong-Koo Chung and a team of eight senior directors. The company is listed on the London Stock Exchange and is owned by shareholders. In 2014, it had a 10.5 per cent share in the global motor car market and has factories in the USA, China, Russia, Turkey, Czech Republic, Brazil and India, in addition to those in South Korea. Hyundai's sales revenue for the period 2011 to 2015 is shown in Figure 4.1.

- 1 Who owns limited companies?
- 2 Who runs limited companies? (Use examples from the case studies.)
- 3 Comment on the size of limited companies, such as those above, compared to sole traders and partnerships.
- 4 In groups, make a list of 20 companies that you know about. Try to decide whether they are large or small.

► Figure 4.1 Hyundai sales revenue, 2011–15



FEATURES OF LIMITED COMPANIES

GENERAL VOCABULARY

sue to make a legal claim against someone, especially for money, because they have harmed you in some way

SUBJECT VOCABULARY

limited companies business organisations that have a separate legal identity from that of their owners

limited liability shareholders are legally responsible for the debts of a company according to how many shares they own

chairperson someone who is in charge of a meeting or directs the work of a committee or organisation

Limited companies are incorporated. This means that they have a separate legal identity from their owners. They can own resources, form contracts, employ people, **sue** and be sued. The other main features of limited companies are as follows.

- The owners have **limited liability**. If a limited company has debts, the owners can only lose the money they originally invested. They cannot be forced to use their own money to pay debts run up by the business.
- The business raises capital by selling shares. Each shareholder owns a number of these shares. They are the joint owners of the company. They are entitled to vote on important matters such as who should run the company. They also get a dividend paid from profits. Those with more shares will have more control and receive more money in dividends.
- The shareholders elect directors to run the company. The board of directors, headed by a **chairperson**, is accountable to shareholders. The chairperson should run the company as the shareholders wish. If the company performs badly, directors can be voted out at an annual general meeting (AGM).
- Whereas sole traders and partnerships pay income tax, companies pay corporation tax on profits.
- To form a limited company, it is necessary to follow a legal procedure. This is outlined below.

FORMING A LIMITED COMPANY

SUBJECT VOCABULARY

certificate of incorporation document needed before a new company can start doing business

A limited company must have a minimum of two members, but there is no upper limit.

Some important documents must be sent to the Registrar of Companies before a limited company can be formed. The two most important ones are the memorandum of association and the articles of association (see Figure 4.2).

If these documents are acceptable, the company will get a **certificate of incorporation**. This allows it to trade as a limited company. The shareholders have a legal right to attend the AGM and must be told of the date and venue in writing.

► Figure 4.2 Memorandum of association and articles of association

Memorandum of Association

This sets out the constitution and gives details about the company. The following details must be included:

- name of the company
- name and address of the company's registered office
- objectives of the company and the nature of its activities
- amount of capital to be raised and the number of shares to be issued.

Articles of Association

This document deals with the internal running of the company. The Articles include details such as:

- rights of shareholders depending on the type of share they hold
- procedures for appointing directors
- length of time directors should serve before re-election
- timing and frequency of company meetings
- arrangements for auditing company accounts.

PRIVATE LIMITED COMPANIES

Most **private limited companies** tend to be small or medium sized. However, a small minority are large. Some features of private limited companies are as follows.

SUBJECT VOCABULARY

private limited company (Ltd) in the UK, a private company limited by shares, which means the liability of the shareholders to creditors of the company is limited to the capital originally invested, a shareholder's personal assets are protected, and with Ltd or Limited after its name; other countries have similar arrangements with different letters after the company name: German GmbH, Polish sp. z o.o., Czech s.r.o., Italian s.r.l. and Slovak s.r.o.

stock market market for shares in PLCs

- Their business name ends in Limited or Ltd.
- Shares can only be transferred 'privately' (from one individual to another). All shareholders must agree on the transfer and they cannot be advertised for sale. Shares in private limited companies cannot be traded on the **stock market**.
- They are often family businesses owned by family members or close friends.
- The directors of these firms tend to be shareholders and are involved in the running of the business.

ADVANTAGES OF PRIVATE LIMITED COMPANIES

Shareholders have limited liability.
 More capital can be raised.
 Control cannot be lost to outsiders.
 Business continues if a shareholder dies.
 Has more status – for example, than a sole trader.

DISADVANTAGES OF PRIVATE LIMITED COMPANIES

Financial information has to be made public.
 Costs money and takes time to set up.
 Profits are shared between more members.
 Takes time to transfer shares to new owner.
 Cannot raise huge amounts of money, like PLCs.

► Table 4.1 Advantages and disadvantages of private limited companies

ACTIVITY 1

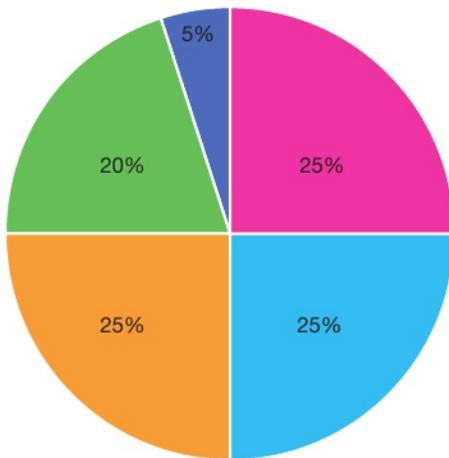
CASE STUDY: KHAN SUGAR MILLS

The Khan Brothers own and run a sugar mill near Multan in Pakistan. Khan Sugar Mills Ltd was first opened in 1984 when the business was set up. However, it was upgraded and modernised in 2001 after the brothers obtained some funding from a Karachi-based venture capitalist, FarmVent. The upgraded plant now has a sugarcane processing capacity of about 12 000 tonnes per day. The business employs more than 350 people in the mill.

The family business operates as a private limited company and made a profit of PKR 543.5 million in 2015. The three brothers own the majority of the business but in 2001 FarmVent took a **stake** in exchange for their funding. Some of the senior managers also own a small stake. Figure 4.3 shows the stakes of each shareholder in Khan Sugar Mills Ltd.

GENERAL VOCABULARY

stake if you have a stake in a business, you have invested money in it



Key

■ Abdul Khan	■ FarmVent
■ Mohsin Khan	■ Senior management
■ Nabil Khan	

▲ Figure 4.3 Khan Sugar Mills Ltd shareholders



▲ A sugar mill

- 1 Name the documents needed to set up a limited company.
- 2 Who controls Khan Sugar Mills Ltd?
- 3 What are the advantages to Khan Sugar Mills of operating as a limited company. Provide two advantages in your analysis.

PUBLIC LIMITED COMPANIES

Public limited companies (PLCs) tend to be larger than private limited companies. Their shares can be bought and sold by the public on the stock exchange. Any person or organisation can buy shares in a PLC.

SUBJECT VOCABULARY

public limited company (PIC) in the UK, a limited company whose shares are freely sold and traded, with a minimum share capital of £50 000 and the letters Plc after its name; other countries have similar arrangements with different letters after the company name: German AG (Aktiengesellschaft), Czech a.s., Italian S.p.A. and Spanish, French, Polish, Greek and Romanian S.A.

prospectus document produced by a company that wants the public to buy its shares

regulatory control official power to control an activity and to make sure that it is done in a satisfactory way

flotation process of a company 'going public'

► Table 4.2 Advantages and disadvantages of public limited companies

KEY POINT

When 'going public' a company is likely to publish a prospectus. This advertises the company to potential investors. It has to be examined by lawyers to ensure that it is not presenting any misleading information about the business. It also invites investors to buy shares before a **flotation**.

'Going public' can be expensive because:

- the company needs lawyers to ensure that the **prospectus** is 'legally' correct
- the prospectus has to be printed and circulated
- a bank may be paid to process share applications
- the company must insure against the possibility of some shares remaining unsold, therefore, a fee is paid to an underwriter who must buy any unsold shares
- there are advertising and administrative expenses
- the PLC must have a minimum of £50 000 share capital.

ADVANTAGES OF PUBLIC LIMITED COMPANIES

Large amounts of capital can be raised.
Shareholders have limited liability.
PLCs can exploit economies of scale.
May be able to dominate the market.
Shares can be bought and sold very easily.
May have a very high profile in the media.

DISADVANTAGES OF PUBLIC LIMITED COMPANIES

Setting up costs can be very expensive.
Outsiders can take control by buying shares.
More financial information has to be made public.
May be more remote from customers.
More **regulatory control** owing to Company Acts.
Managers may take control rather than owners.

FEATURES OF MULTINATIONALS

SUBJECT VOCABULARY

multinational company large business with significant production or service operations in at least two different countries

Multinational organisations have become very important in recent history. A **multinational company** is a large business with significant production or service operations in at least two different countries. Examples include McDonald's, Toyota, British Petroleum, Microsoft and Coca-Cola. Some of the key features of a multinational include:

- **huge assets (land, buildings, plant, machinery and money, for example) and turnover:** multinationals are extremely well-resourced and can often afford to take on large-scale contracts and projects that many other firms could not cope with
- **highly qualified and experienced professional executives and managers:** multinationals can afford to hire the very best people from anywhere in the world
- **powerful advertising and marketing capability:** they can invest huge amounts of money in impressive advertising campaigns to outcompete smaller rivals
- **highly advanced and up-to-date technology:** multinationals can afford to keep right up to date with technological developments so that they always have the most efficient factories, machinery and equipment that can help to lower costs
- **highly influential both economically and politically:** they can be very powerful and even influence government decision making

DID YOU KNOW?

The biggest multinational company in the world in 2015 was the US company Wal-Mart. The giant supermarket chain had sales revenue of US\$4 857 000 million.

- **very efficient since they can exploit huge economies of scale:** because multinationals are so large, they have the ability to reduce their costs significantly – they can buy huge quantities of raw materials more cheaply, for example
- **ownership and control is centred in the host country:** the control of multinationals is nearly always held in the country where the company was first established. This means that profits are always returned to this country.

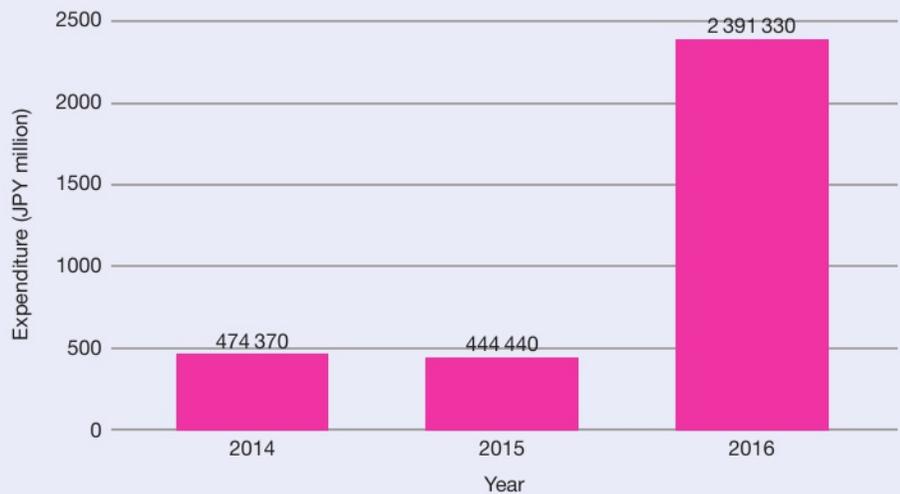
The growth and importance of multinationals is discussed in detail in Chapter 10, pages 72–80.

ACTIVITY 2**CASE STUDY: SONY**

Sony is a huge Japanese-based multinational. It manufactures and markets a range of electronic goods including televisions, digital cameras, video cameras, Blu-ray Disc™ players and recorders, video games, semiconductors and other electronic components. In 2016, Sony employed over 125 000 people across the world and enjoyed sales of about US\$80 000 million. Sony has factories, offices and technology centres in many countries around the world including Japan, China, Europe, the USA and India. The value of Sony's assets at the end of June 2016 was US\$159 450 million.

Sony is a highly recognisable global brand. The strength of the brand has been developed over many years of successful trading. However, to support the brand Sony continues to invest heavily in global advertising. Figure 4.4 shows the amount of money Sony spent on worldwide advertising between 2014 and 2016.

► Figure 4.4 Sony expenditure on advertising worldwide, 2014–16



- 1 What is meant by the term multinational?
- 2 What evidence is there to suggest that Sony is a multinational?
- 3 Describe two features of multinationals. Use examples from the case study.

LARGE VS SMALL BUSINESSES

Quite a number of small- and medium-sized businesses operate as private limited companies. They are often family businesses and ownership may be shared between members of the same family. Many public limited companies are large and some, like multinationals, are very large indeed. However, there may be exceptions. For example, Dell the giant US computer company is privately owned by Michael Dell.

MULTIPLE-CHOICE QUESTIONS

SUBJECT VOCABULARY

issue (shares) sale of new shares

- ▶ **1 Which document would be issued to a limited company giving it permission to trade?**
 - A Memorandum of association
 - B Articles of association
 - C Certificate of incorporation
 - D Prospectus

- ▶ **2 Which item of information would be contained in the memorandum of association?**
 - A Rights of shareholders
 - B Name of the company
 - C Price of the shares to be issued
 - D Procedures for appointing directors

- ▶ **3 Selling shares to the public for the first time to raise capital for a company is called a:**
 - A Flotation
 - B Prospectus
 - C Joint venture
 - D Venture capital

- ▶ **4 Which of the following is a disadvantage of a private limited company?**
 - A Shareholders have limited liability
 - B Owners have to share the profits with 'outsiders'
 - C It can take time to transfer shares to a new owner
 - D Control could be lost to 'outsiders'

CHAPTER REVIEW

CASE STUDY: HKOFFICESUPPLIES.COM

Lee Kwok Hung is the majority shareholder in Kwok Hung Office Supplies Ltd. The three other shareholders are family members who all work in the business. The company is based in Kowloon and serves the whole of Hong Kong. It delivers a wide range of office supplies, including stationery (such as pens, paper and staplers), office equipment, office furniture and other office accessories. Lee started the business in 2004 when he operated as a sole trader supplying just stationery. However, in 2009, he invited family members to take a stake in the business and formed Kwok Hung Office Supplies Ltd, a private limited company. They contributed some capital and the business expanded.

► Example of an advert for office supplies

OFFICE SUPPLIES

Over 60000 items available for overnight delivery to help you keep your office in shape

- Batteries ● Binders & Accessories ●
- Calendars & Planners ● Clips ● Copy Paper & Pads ● Desk Accessories ● Envelopes & Forms ● Glue & Adhesives ● Labels & Markers ● Mailroom & Shipping ● Office Tape ● Rubber Bands ●
- Scissors ● Rulers ● Self Stick Notes ● Staplers ● Tape Flags ● Writing & Correction ● Calculators



The family is now considering raising more money by 'going public'. Lee wants to expand the business further and needs HK\$200 million. This will be used to:

- develop an online business
- build a large distribution centre
- purchase delivery vehicles to serve the wider South China area
- buy stock to supply a complete range of office supplies and accessories.

The company also plans to change its name to HKofficesupplies.com.

CHAPTER QUESTIONS

1 What is meant by the term private limited company?

When Kwok Hung Office Supplies Ltd was formed, Lee had to produce a memorandum of association.

2 What information would this document contain?

3 What is the purpose of a prospectus?

Share issues have to be underwritten.

4 What does this mean?

5 Why is going public expensive?

6 Discuss whether Lee should convert his business to a public limited company. Make a clear judgement at the end of your evaluation.

5 PUBLIC CORPORATIONS

LEARNING OBJECTIVES

- Understand the features of public corporations
- Understand the ownership, control, sources of finance and use of profits for public corporations
- Understand the reasons for and against public ownership
- Understand the nature of, and reasons for, privatisation

GETTING STARTED

In most countries around the world, some business activity is undertaken by government-controlled organisations. They are not owned by individuals and often have different objectives. In many countries, public services, such as health care, transport and education, are provided by public corporations. In others, commercial goods and services, such as banking, oil production and energy, are also provided. Look at the example below.

CASE STUDY: THE UGANDAN NATIONAL WATER AND SEWERAGE CORPORATION

Water and sewerage services in Uganda, like many other countries in the world, are supplied by a government-owned organisation. The Ugandan National Water and Sewerage Corporation (NWSC) is owned 100 per cent by the Ugandan government. Its mission is 'To sustainably and equitably provide cost effective quality water and sewerage services to the delight of all stakeholders while conserving the environment.' The organisation is run by a board of directors which is accountable to a government minister.

NWSC has enjoyed a successful period in recent years. Its turnover in 2017 was UGX320 billion. NWSC now has a presence in 218 towns, a large increase from only 24 towns in 2011. It has increased account holders from 58 260 in 1998 to 530 000 in 2017. NWSC employs over 2800 people and has also improved its **productivity**. For example, in 1998, it took 36 staff to make 1000 connections; in 2017, this was reduced to 6 staff per 1000 connections.

NWSC is committed to providing good quality customer service. It aims to supply everyone with clean, safe water within 200 metres of all towns and urban centres (coverage is currently 78 per cent). It links up with customers and local communities through NWSC Water Communication Clubs. On the NWSC website it states that 'The Customer is the reason we exist. We do everything to the delight of our customer.' According to annual surveys carried out by NWSC, 90 per cent of its customers are satisfied with the service provided.

SUBJECT VOCABULARY

productivity rate at which goods are produced, and the amount produced, especially in relation to the work, time and money needed to produce them

► Bringing water to the people



- 1 Who owns and runs the Ugandan National and Water Sewerage Corporation?
- 2 Suggest what the objectives of the NWSC might be.
- 3 Why do you think the government gets involved in business ownership?

FEATURES OF PUBLIC CORPORATIONS

SUBJECT VOCABULARY

public corporations business organisations owned and controlled by the state/government

- **State owned:** The government owns **public corporations**. This means that the government appoints the people who run the organisations, often a board of directors. The government is also responsible for the corporation's policies.
- **Created by law:** Public corporations are created by an act of parliament. The powers and duties of each organisation are specified clearly in the act.
- **Incorporation:** Public corporations are incorporated businesses. This means they have a separate legal identity. They can sue, be sued and enter into contracts under their own name.
- **State-funded:** The government provides the capital needed by public corporations. The money comes mainly from tax. All the assets and liabilities of public corporations belong to the state, but corporations can also borrow money and are free to re-use revenue from the sale of any goods or services.
- **Provide public services:** Most, but not all, public corporations do not aim to make a profit. Their main objective is to provide a public service. For example, Air India provides international air transport in India, Televisión Española (TVE) provides a national broadcasting service in Spain and the NHS provides free health care in the UK. Profit is not usually the driving force behind public corporations.
- **Public accountability:** Public corporations have to produce annual reports, which are submitted to the government minister in charge of the particular corporation. Ultimately, they are accountable to taxpayers because state-owned corporations are accountable to the public. If a public corporation makes a profit, the money will either be reinvested in the business or handed over to the government.

SUBJECT VOCABULARY

portfolio collection (of business interests or products)

DID YOU KNOW?

Some large public corporations are part owned by the private sector. For example, the government owns about 60 per cent of the State Bank of India and private individuals, financial institutions, foreign institutions and other private investors own the rest.

SUBJECT VOCABULARY

infrastructure basic systems and structures that a country or organisation needs in order to work properly

- ▶ SNCF has made huge investments in infrastructure

The nature and number of public corporations around the world can vary in each country. Although a great number of public corporations around the world exist to provide a public service, there are many that operate commercially with the aim of making a profit. In the UAE, the government owns a number of large businesses that aim to make a profit – Emirates Airline and Dubai World, a holding company that manages and supervises a **portfolio** of businesses and projects for the Government of Dubai, are examples.

ACTIVITY 1

CASE STUDY: SNCF GROUP

SNCF Group is a global company that provides passenger and freight transport services. It consists of three enterprises: SNCF, SNCF Réseau and SNCF Mobilités. SNCF Réseau is France's state-owned railway company. Under French law, SNCF Réseau is an établissement public industriel et commercial – a public service company with a commercial and industrial mission, owned by the French state. Its mission is to provide a nationwide railway network. SNCF Réseau is committed to customer satisfaction and makes social progress a priority. It aims to promote regional growth and development throughout France. It has recently launched a range of projects to:

- improve punctuality for people travelling to work
- make fares easier to understand
- make the rail system more accessible for all.

These projects include a programme to gradually improve stations and trains, and to develop services for people with disabilities.

SNCF Group generated revenues of €32 273 million in 2016, which was 2.8 per cent higher than the previous year, and made a net profit of €567 million. This is a significant improvement as despite investing over €4000 million in infrastructure and making productivity gains, SNCF Group made a net loss of €12 228 million in 2015.



- 1 Using this case as an example, describe three features of a public corporation.
- 2 Who will take financial responsibility for the losses made by SNCF in 2016?

REASONS FOR THE PUBLIC OWNERSHIP OF BUSINESSES

The amount of business activity taking place in the public sector has fallen in many countries in recent years. However, public corporations, and other public sector organisations, still provide a wide range of important services. What are some of the main reasons for public ownership?

GENERAL VOCABULARY

duplication repeat of something
provision providing something that someone needs now or in the future

SUBJECT VOCABULARY

natural monopoly market where it is more efficient to have just one organisation meeting total market demand

- **Avoid wasteful duplication:** In some industries, a **natural monopoly** exists. This means it is more efficient to have just one business providing a service for the whole market. Such industries include rail transport and public utilities where a large infrastructure is needed before trading can begin. It would be a waste of resources if, for example, two or more water companies built their own system of pipes to distribute water to all households in an area.
- **Maintain control of strategic industries:** It may be argued that it is better for industries that are vital to the nation's security, such as energy production and water supplies, to be owned by the government. This would prevent 'outsiders' from another country taking them over and exploiting the nation. If the **provision** of a particular service is vital to the well-being of the nation, it is considered desirable for the government to maintain control so that a reliable supply and quality can be guaranteed.
- **Save jobs:** In some cases, businesses have been taken into public ownership to save jobs. A government might take control of a failing private sector business if it employs very large numbers of people. It might be preferable to allow a business to carry on trading even though it is losing money if it prevents mass unemployment. For example, one of the reasons why Prestwick Airport, Glasgow was taken into public ownership in 2013 was to save 1400 jobs (3200 jobs linked to the airport were also saved).
- **Fill the gaps left by the private sector:** In some markets, the private sector will not make an adequate provision to meet the market's needs. For example, it is desirable that everyone gets an education because it benefits society as a whole. However, the private sector would only provide school places for those who are prepared to pay. Consequently, a large number of children would be left inadequately educated because their parents either could not afford to pay or would choose not to pay.
- **Serve unprofitable regions:** In some markets, the private sector would not deliver important services to unprofitable regions. For example, the cost of providing electricity to a remote farm many miles away from the main power lines would be too high for a private sector operator. However, a public corporation may be prepared to meet this cost because profit is not a key objective.

REASONS AGAINST THE PUBLIC OWNERSHIP OF BUSINESSES

It is argued by some that the government should not run businesses. This is because public ownership has some drawbacks.

SUBJECT VOCABULARY

subsidise paying part of the costs (often by the government in business)

- **Cost to government:** A number of public corporations make losses. These losses have to be met by the taxpayer. For example, in Activity 1 above, SNCF, the French rail transport provider, made a loss of €2176 million in 2015. If losses get bigger, and more frequent, taxpayers might object to the financial burden. Also, any money used to **subsidise** public corporations cannot be used for more attractive alternatives, such as improving international security.
- **Inefficiency:** Public corporations are often criticised for their low productivity and inefficiency. For example, public sector rail providers are often criticised for the poor reliability and regular lateness of trains. The cause of such inefficiency is often blamed on a lack of competition, the absence of profit as an objective and the knowledge that they cannot 'go

bust' because losses will be met by the government.

- **Political interference:** Public corporations often suffer owing to government interference. This may occur because different governments have different views about the way public corporations should operate. As a result, corporations are subject to policy changes every time a new government is elected. For example, a new government may decide that public corporations should raise prices to generate more revenue.
- **Difficult to control:** Some public corporations are very large. They may employ many thousands of workers spread across a wide geographical area and own huge quantities of physical assets. This might make it difficult to co-ordinate different parts of the business and run it effectively. For example, the NHS in the UK employs about 1.5 million people. It is one of the biggest employers in the world. With such a large workforce, and so many different operational locations, managing the organisation can be very challenging.

PRIVATISATION

SUBJECT VOCABULARY

privatisation transfer of public sector resources to the private sector (business)

In many countries, the number of public corporations has been reduced. For example, in the UK, industries such as rail transport, water provision, electricity generation and distribution, and telecommunications have been transferred to the private sector. Many Eastern European countries have also transferred a lot of government-run businesses into the private sector following the break-up of the Soviet Union. The process of transferring public sector resources to the private sector is called **privatisation**. Privatisation can take a number of forms.

- **Sale of public corporations:** The sale of public corporations has been a popular way of transferring business activity from the public to the private sector. One way of doing this is to sell shares in the business to anyone that wants them. In some cases, governments have sold off parts of state-owned businesses over a period of time. For example, in 1997 the Australian government sold off the first third of the telecommunications business Telstra for A\$13 700 million. Sales of the second and third thirds followed in 1999 and 2006.
- **Deregulation:** This involves lifting legal restrictions that prevented private sector competition. For example, in the UK the deregulation of the communications market has allowed companies such as Sky to compete with British Telecom.
- **Contracting out:** Many government and local authority services have been 'contracted out' to private sector businesses. This is where contractors are given a chance to bid for services previously supplied by the public sector. Examples include the provision of school meals, hospital cleaning and refuse collection.
- **The sale of land and property:** One example of this in the UK was the sale of council-owned properties to the tenants. They were given generous discounts, if they agreed to buy.

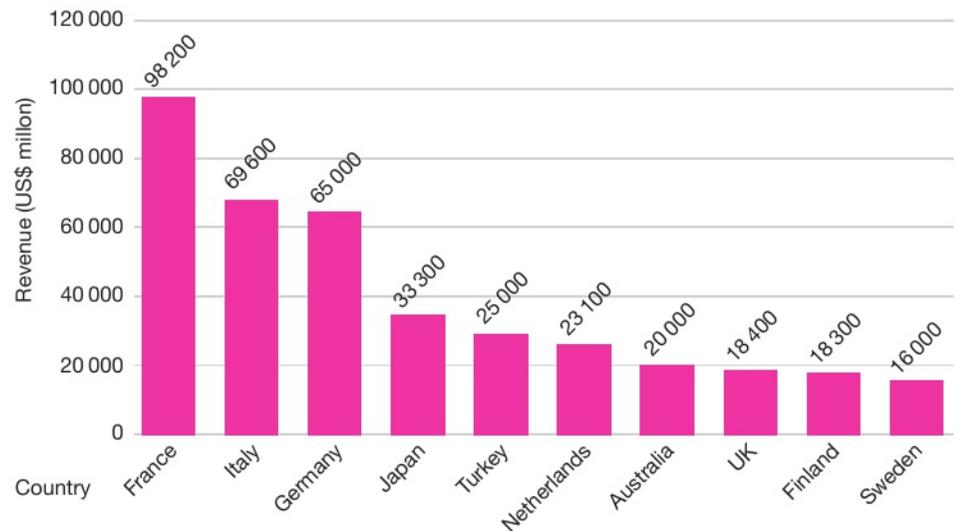
WHY DOES PRIVATISATION TAKE PLACE?

Different reasons have been put forward for the privatisation of government-owned resources.

- **To generate income:** The sale of state assets generates income for the government. Figure 5.1 shows the money raised by OECD countries between 2000 and 2007. These countries have raised very large amounts of money.
- **To reduce inefficiency in the public sector:** Many public corporations lacked the incentive to make a profit and often made losses. It was argued that in the private sector they would have to cut costs, improve services and return profits for shareholders. They would also be more accountable.

- **As a result of deregulation:** Legal barriers were removed that allowed new businesses in some markets, such as bus and coach services. Existing firms were privatised so that new firms could be encouraged to join the market.
- **To reduce political interference:** In the private sector, the government could not use these organisations for political aims. They would be free to choose their own investment levels, prices, product ranges and growth rates, for example.

► Figure 5.1 Privatisation revenues – top ten OECD countries, 2000–07



ACTIVITY 2

CASE STUDY: AIRPORT PRIVATISATION

Historically, governments have preferred to keep ownership of businesses operating airports. They were seen as very important to the nation and therefore in need of close state control. Even as recently as 2006, only about 2 per cent of the world's airports were owned or managed by the private sector. However, in recent years there has been a rapid growth in the privatisation of airports and airport facilities. For example, in 2014, the Indian Aviation Authority went ahead with plans to sell off Sardar Vallabhbhai Patel International Airport in Ahmedabad. Brazil has also opted to privatise airports. In 2013, the Brazilian Government raised US\$9100 million by privatising two major airports ahead of the 2014 World Cup. More recently, in 2016, it was reported that Brazil wanted to raise a further US\$1400 million by selling stakes in five of its airports. The money is needed by the Brazilian government to help reduce its budget deficit. (The government is spending more than it earns from tax revenues.)

One of the motives for privatisation is that airports are likely to be run more efficiently in the private sector. According to Ahmed Bukalla, director of operations at the Department of Civil Aviation, Sharjah International Airport, UAE, 'When privatisation comes, there will be pressure for further productivity gains, and airport operators will need to be even more innovative and adopt new technologies to stay competitive.'