

Section 3.1

WHAT IS BUSINESS?

THIS SECTION OF THE SPECIFICATION COVERS:

- ☐ Understanding the nature and purpose of business
- ☐ Understanding different business forms
- ☐ Understanding that businesses operate within an external environment

0 1 GIVE ME THREE...

Business objectives:

| | |
|----------|-----------|
| 1 | Survival |
| 2 | Cash flow |
| 3 | Growth |

Reasons why businesses set objectives:

| | |
|----------|---|
| 1 | Everyone will be working towards the same goal, increasing efficiency |
| 2 | Motivational tool for staff, as they are clear of their role |
| 3 | Enables progress to be measured aiding future decision-making |

Reasons why a business has a mission statement:

| | |
|----------|--|
| 1 | Establishes direction of the business |
| 2 | Forms the basis of alignment with the owner(s) and all employees |
| 3 | Informs the public of the reason why the firm exists |

Examples of variable costs and fixed costs:

| | VARIABLE COSTS | FIXED COSTS |
|----------|----------------|---------------------|
| 1 | Raw materials | Management salaries |
| 2 | Direct labour | Rent |
| 3 | Fuel | Insurance |

0 2 WHAT'S THE DIFFERENCE?

What's the difference between:

THE MISSION OF A BUSINESS AND THE OBJECTIVES OF A BUSINESS

- The mission refers to the organisation's long-term intentions and details its overall purpose
- Objectives are SMART and set out how the aims of the organisation will be achieved

A PRIVATE LIMITED COMPANY AND A PUBLIC LIMITED COMPANY

- A private limited company has Ltd after its name in contrast to a public limited company which has a plc after its name
- Private limited companies are usually smaller than public limited companies
- Many private limited companies are owned by families/friends i.e. there is control over who can buy shares in the business; there are no restrictions who can buy shares in a plc
- Minimum capital requirement for a plc is £50,000; there is no requirement for a Ltd
- Plcs must publish more detailed financial accounts compared to a Ltd

LIMITED LIABILITY AND UNLIMITED LIABILITY

- Limited liability is the legal protection offered to shareholders in public and private limited companies, whereby if the business experiences financial difficulty, the shareholders responsibility for paying any debts will be restricted to the value of the fully paid up shares; the personal possessions of shareholders are therefore protected
- Unlimited liability means that the owners of an unincorporated business, for example a sole trader, are responsible for all the debts of the business; this may involve selling personal possessions in order to pay business debts

THE OBJECTIVES OF A SOLE TRADER AND THE OBJECTIVES OF A PUBLIC LIMITED COMPANY

- Sole trader: survival; being own boss; to provide sufficient income to have a comfortable standard of living; provide a service to locals/pursue an interest
- Public limited company: linked to efficiency, cost savings, increase in sales/market share, growth, profit maximisation, increase in share value

PRIVATE AND PUBLIC SECTOR ORGANISATIONS

- Private sector organisations are run by individuals or groups of individuals, rather than being run and controlled by the government
- The public sector consists of those organisations which are owned and controlled by the government on behalf of the public

ORDINARY SHARE CAPITAL AND MARKET CAPITALISATION

- Ordinary share capital is the total value of the shares when they were first issued and is permanently invested in a company; it is calculated by the number of ordinary shares x share price when first issued; this figure will not change
- Market capitalisation is the current value of the issued ordinary share capital of a plc; it is calculated by: current share price x number of ordinary issued shares; the market capitalisation figure will therefore change

0 3 BENEFITS AND DRAWBACKS

Identify two benefits and two drawbacks of these forms of business organisation:

SOLE TRADER

BENEFITS

- Decision-making is fast, therefore the business can respond quickly to changing situations
- Owner is able to keep all the profits
- Financial accounts do not need to be published
- Easy and cheap to set up
- Owner has full control over the business

DRAWBACKS

- Unlimited liability
- Lack of capital
- Limited collateral to support bank loans
- Difficulty to take time off
- Stressful
- Limited skill base

PRIVATE LIMITED COMPANY

BENEFITS

Incorporated business therefore benefits from limited liability
Full control over who is able to buy shares
Access to more capital compared to a sole trader
Less financial information is available to the public compared to a plc

DRAWBACKS

More difficult to raise large amount of funds through share capital compared to a plc
Financial accounts are available to view by the general public
More expensive and time consuming to set up compared to a sole trader

PUBLIC LIMITED COMPANY

BENEFITS

- ☑ Incorporated business therefore benefits from limited liability
- ☑ Can raise large amounts of finance through selling shares on the stock exchange
- ☑ Can receive favourable media attention
- ☑ Ability to expand quickly

DRAWBACKS

- ☒ Expensive to set up
- ☒ Must publish detailed financial information
- ☒ Could be subject to a takeover
- ☒ Pressure to maximise short-term profits rather than focus on the long-term direction of the firm

0 4 EXAMPLES AND SITUATIONS

Give an example (with a brief description of the business activity) of a:

NON-PROFIT ORGANISATION

- Many different forms of non-profit organisation exist e.g. charities, social enterprises, community groups; they may make a profit, but the profits are reinvested back into the organisation in order to meet its objectives rather than being distributed to owners

PUBLIC SECTOR ORGANISATION

- Government provides public services to all citizens in the country: NHS, education
- Local government provide municipal services to local areas: libraries, parks, leisure centres

0 5 REASONS WHY

Give two reasons why...

SHARE PRICES CHANGE

1

If the financial performance of the company is strong, the business may get favourable publicity which will push the share price up

2

If the economic outlook is uncertain, investors may lose confidence about the future performance of a business and look to sell their shares; if there are a large number of shareholders that wish to sell, this may reduce the share price

SHARE PRICE CHANGES ARE SIGNIFICANT TO THE SHAREHOLDERS OF A COMPANY

1

It will directly impact on the value of their shareholding; if a shareholder was looking to sell their shares, an increase in the share price could result in the shareholder making a capital gain on the sale of his/her shares

2

A falling share price may result in the company being taken over; the original founders/shareholders of the business may lose control

SHAREHOLDERS PURCHASE SHARES IN A COMPANY

1

To receive dividends

2

To make a capital gain

A PRIVATE LIMITED COMPANY MIGHT CHANGE INTO A PUBLIC LIMITED COMPANY

1

To raise share capital to finance expansion

2

To increase the exposure/reputation of the business

0 6 GIVE ME THREE...

Factors that can influence costs and demand:

| | COSTS | DEMAND |
|----------|--|---------------|
| 1 | Interest rates | Demographics |
| 2 | Environmental issues | Income levels |
| 3 | Legislation e.g. with regards to the minimum wage and the national living wage | Competition |

0 7 WHAT'S THE FORMULA?

Write down the formula for calculating:

| TOTAL REVENUE | TOTAL COSTS |
|--|---|
| Selling price per unit x number of units sold | Fixed costs + variable costs |
| PROFIT | MARKET CAPITALISATION |
| Total revenue – total costs OR Total contribution – fixed costs | Number of issued shares × current share price |

0 8 WHAT IS MEANT BY?

Write a definition for the following key terms:

| | |
|-------------------------------|--|
| CHARITIES | An organisation that is set up with the intention of raising money for those in need |
| DEMOGRAPHIC FACTORS | A study of the population e.g. the UK has an ageing population |
| DIVIDENDS | The share of the profit after tax that a company distributes to its shareholders according to the number of shares that they hold; a company does not have to issue a dividend payment |
| ETHICAL OBJECTIVES | Moral objectives that a business sets |
| EXTERNAL ENVIRONMENT | Factors that can influence business activity, but the business has no direct control over e.g. a change in legislation |
| FAIR TRADE | Paying producers in developing countries fair prices for their products; farmers can then benefit from a better standard of living |
| INTEREST RATES | The cost of borrowing or the reward for saving |
| MARKET CONDITIONS | Characteristics of a market that a business/product will operate or operates in e.g. the growth rate, number of competitors |
| MUTUALS | Organisations that are set up and run for the benefit of their members e.g. a building society |
| ORDINARY SHARE CAPITAL | Value of shares when they were first issued x the number of shares initially issued; funds that are permanently invested by shareholders |
| SHAREHOLDER | A part owner of a company who owns at least one share |