

Business

GCSE Business Studies Notes

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Business

Business Basics

Main aim is to make money.

1. Aim to be the biggest. – eg. McDonalds
2. Aim to be quality. Eg. Ferrari and restaurants eg Mizu sushi
3. satisfying customers.
4. expanding the business

The economy – 2 sectors

- The public sector (Government)
- Private sector (Business / charity)

Free market economy- very little government control.

Planned economy – high government control.

Mixed economy – public and private sector.

Types of business

Sole trader

Single person (an ice cream truck owner)

Advantages:

easy to set up

get to be your own boss

you can keep the profit

Disadvantages:

If you owe money, its all down to you

Sue you personally (they can take everything from you).

Partnership

When two or more people own a business (only from 2-20 people) for eg. Architects

Deed of partnership, a document that include rules of a partnership.

Advantages:

More money

more ideas

Banks are more willing to lend you money.

Disadvantages:

Disagreements

Both are responsible

They both are on unlimited liability for example. They can even take your house

Limited company

The business its is own identity

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Limited liability

A memorandum of association – who and where

Article of association – how the business is run (a documentation).

Its owned by shareholders.

Private – shares can only be bought with an agreement. (Ltd.)

Advantage:

Have control over it,
can be small companies

Disadvantages:

Have to do more paperwork
Have to publish your accounts.

Public (Plc) – shares can be bought by anybody. More access ro funds, and more money is available (capital). – good way to expand the business.

Advantages –

Disadvantages –

Other people can take over your company.

Franchise

Example: NIKE, McDonalds, secret recipe.

Advantage:

For the franchisee is that they get to own a brand and also get the systems

Disadvantage:

Is that freedom is limited.

The franchisor has the

Advantage - that the business expands with little capital.

Disadvantage - is that they don't get to keep all the profit and they don't have complete control over that section. It gets more difficult when it gets overseas.

Cooperative

Owned by the workers like in villages, they might share outcomes from fields.

Public corporations

Something that's owned by the government for example 'petronas' in Malaysia . the BBC and BC (British council).

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Marketing

4p's (the marketing mix)

- Product
- Price
- Promotion
- Place

2 types of market

Mass market – gardenia, MS Windows and coca cola.

Niche market - specific for small market.

Example Niches - Sports prescription sun glasses / LED lights for furniture / chandeliers / egg ornaments

Market segments

Age, gender, social class (A-E), location, culture or religion, income, size of household and people in it.

Field research (primary research) – doing your own work.

E.g. questionnaires, telephone surveys, product testing, focus groups. (E.g. Asking kids to play games before they are released)

Desk research (secondary)

Pros - Cheap, easily found and instantly available

Cons - Not always relevant, not specifically about your product, its out of date, your competitors also have access to the same research.

Can be either quantitative or qualitative.

Data types

Quantity – i.e. numbers, quick to analyze and not much interpretation (Example multiple choice test)

Quality – Good quality (Not numbers) - Difficult to analyze, requires human interpretation (Literature / writing).

Choosing a sample

5. random sample – just complete random.
6. quota sample. – don't know names but you know the characteristics. (In a school, you know the kids age range but you don't know their names), used in shopping centers
CCTV observing people.
7. target sampling – you know exactly what you need to know about them.

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Product

Be market driven, not product driven (means give people what they want)

Example: iPhone, people care about user friendliness not the hardware inside. As opposed to Nokia who have 5 Mega pixel cameras and other good functionality but not as easy to use. (Nokia's key weakness, the software on the PC. Driven by phone specs not the PC software which is what people want now)

know yourself and your market

SWOT

Strength

Weaknesses

Opportunities

Threats

Nike

Strengths (Internal)

- Brand recognition
- Shoes look good
- Worn by best athletes
- Better for basketball – Ankle guard and cushioning

Weaknesses (Internal)

- Shoes are not comfortable (give blisters)
- New shoes not always of a high standard
- Do not last very long (Particularly walking shoes)

Opportunities (External)

- Sell to basketball players and wannabies
- Sell to fashion conscious consumers

Threats (External)

- Other brands are more comfortable (Make shoes more comfy)
- Improve quality control (To improve lifespan and presentation when new)

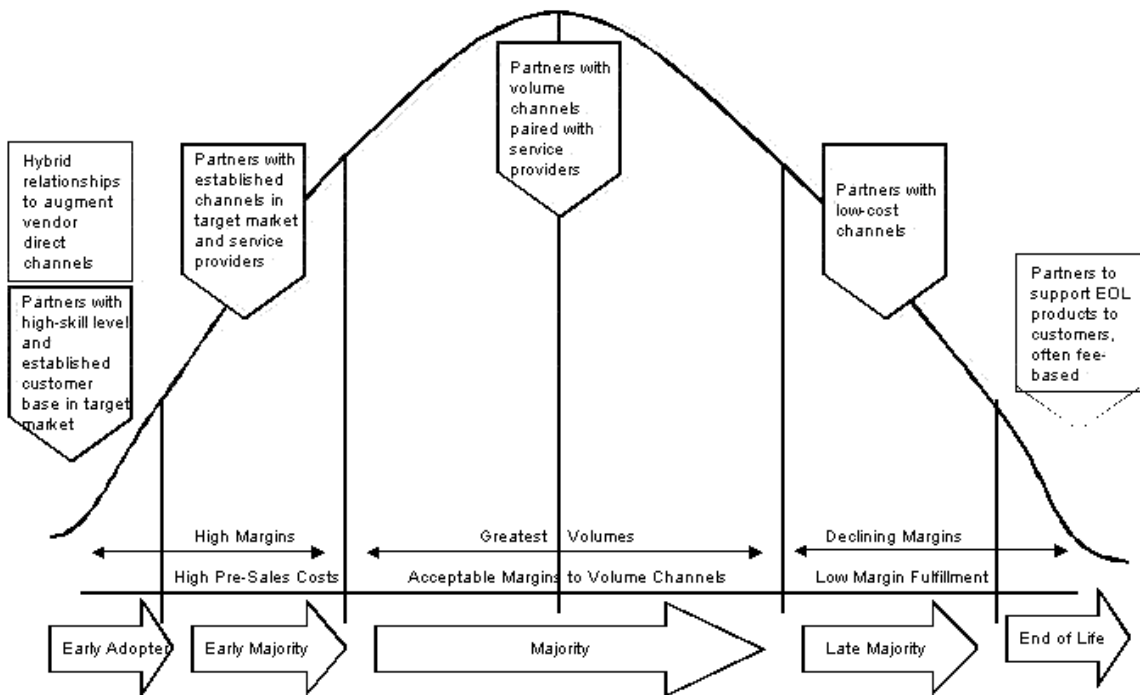
Detail

Design, product name, brand image, product range and packaging

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Product Life Cycle

Product Life Cycle Channel Map



Make your product different from your competitors

- Design / features (Ferrari)
- Brand Image (Lamborghini)
- Reliability (Toyota)
- Cheaper (Proton)

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Price

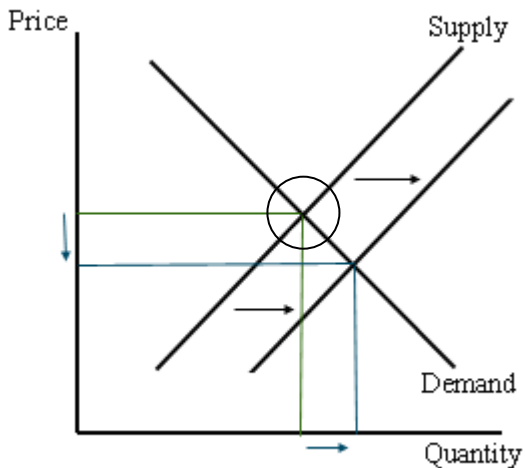


Figure 2.

Equilibrium – is where the lines meet in the middle.

- If price is too low there will be a shortage
- If price is too high there will be a surplus
- If the price is right then there will be equilibrium

Price elasticity

$$\text{Price elasticity of demand} = \frac{\% \text{change of quantity demanded}}{\% \text{change in price}}$$

% change in quantity demanded	-10	Price elasticity	-0.5
%change in price	20		

Pricing Strategies

Market Led pricing

- Penetration Pricing – Charge a low price to get into the market and then raise it. (Air Asia)
- Skimming – Charge a high price and then lower it. (iPhone / technology)
- Destroyer – Charge a very cheap price to get rid of competition. – Office of Fair Trading (UK) try to stop this, because it is anti-competitive behaviour - (giant supermarket)
- Price discrimination – Charge different prices to different people. E.g. Discounts for old people / students (stationery – calculator)
- Competition pricing – (Mydin and Giant)

Cost plus pricing

Product cost + Mark up (%)

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£2 cost + 25% = £2.50

Mark up **DOES NOT** equal profit margin

Promotion

- Awareness
- Remind people – to make sure they carry on buying your product.
- Persuade people to switch to your brand (Nike & adidas).
- Improve your image – (Shell petrol station and BP & tag heur).

(Always want to sell more stuff)

Where they advertise

- Advertising budget.
- Target audience.
- Size of your market.

Informative or Persuasive

Informative advert: national geographic

Persuasive advert:

- Global warming advert (With girl in the ice)
- Road safety adverts (Helmets, seat belts and crossing the road)

Medium (Plural: Media)

Medium	Advantages	Disadvantages
Television	Sound and vision and reaches nearly everybody	Cost a lot of money – limited availability
Radio	Sound and reaches nearly everybody	Difficult to remember adverts, only sound.
Newspapers & Magazines	You can see and refer to it, target your audience more specifically.	It can be just skipped and the print quality. Static and silent.
Posters and billboards	Big, everybody can see them	You can't put much on them, people can't remember them.
Cinema adverts	As good as television, captive audience	Cost a lot for the audience size, you may not get everybody.
Leaflets & direct mail	Good to target	They can be ignored and they may hurt your brand image.
The web	Most people have access to it, interactive and international	You have to want to go to the site and lots of competition.

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		Search engines take a long time to build rank.
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Advantages of advertising

- Get to sell more stuff
- More awareness of the company

Disadvantages of advertising

- Cost a lot of money
- Difficult to measure effectiveness
- Opportunity cost (if you do something, you can't do another) You are doing your revision, the opportunity cost is that you can't go to the Grand Prix. (You hope to get better GCSE grades, go to a decent uni and make a tonne of money)

7 main methods of promotion

1. BOGOF buy one get one free
2. discounts
3. competitions
4. free gifts
5. Product trials
6. Point of sale advertising (free samples, in supermarkets-nescafe)
7. use of credit – (pay for something later on, cars)

Personal selling
Using sales people

Public relations

Free publicity but you don't control it (good/bad) M
Most large companies have PR departments to encourage good news to get to the media and lessen the effect of bad news.

Product Placement

Placing products in films... Such as the use of the Sony phone in James Bond, celebrities wearing jewellery (At the Oscars)

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Place

Direct: Manufacturer – Consumer
(Order from a Website or mail order)

Book from the site -> Comes straight from the publisher (2 or 3 days)

Indirect: Manufacturer – Wholesaler – Retailer – Consumer
(Easier to distribute to a larger number of people.)

Book (Marshall Cavendish) -> Singapore (Wholesaler) -> Distribute to bookshops in Malaysia and Singapore -> Consumer (6 weeks)
Benefit: Distribute books to the whole country

Two choices:

Distribute to everybody -> Mass marketing and product

Selective -> Ferraris are not sold in the local Proton garage

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Production

Primary Sector



(Farms / Cutting down trees / mining)

Secondary Sector



(Factory/builders/gas and electricity providers)

Capital Goods – used to make other goods or provide services. (Delivery vans / factory equipment etc)

Consumer Goods – Sell to consumers

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Tertiary Sector



(Providing services / shops/tuition/hospitals/cafeterias etc)

*Some services are business to business
Some are business to consumer*

Specialisation and Interdependence

Firms use Specialisation to make their production more efficient. Its called *division of labour* – divide up the work and each person does a *specific job*, (Ford was instrumental in doing this)

Advantages

- Workers can play to their strengths
- Skills are improved
- Firms can break up complex production techniques into simple steps. (Reduce cost of labour)
- Workers repeat the same task and become very quick

Problems

- Get Really Bored
- People don't care – poor quality products, absenteeism and industrial action
- One group of people can stop complete production (For example the writers in the US went on strike costing millions of dollars)
- Workers can become over specialist and not flexible (Can't change their jobs – English

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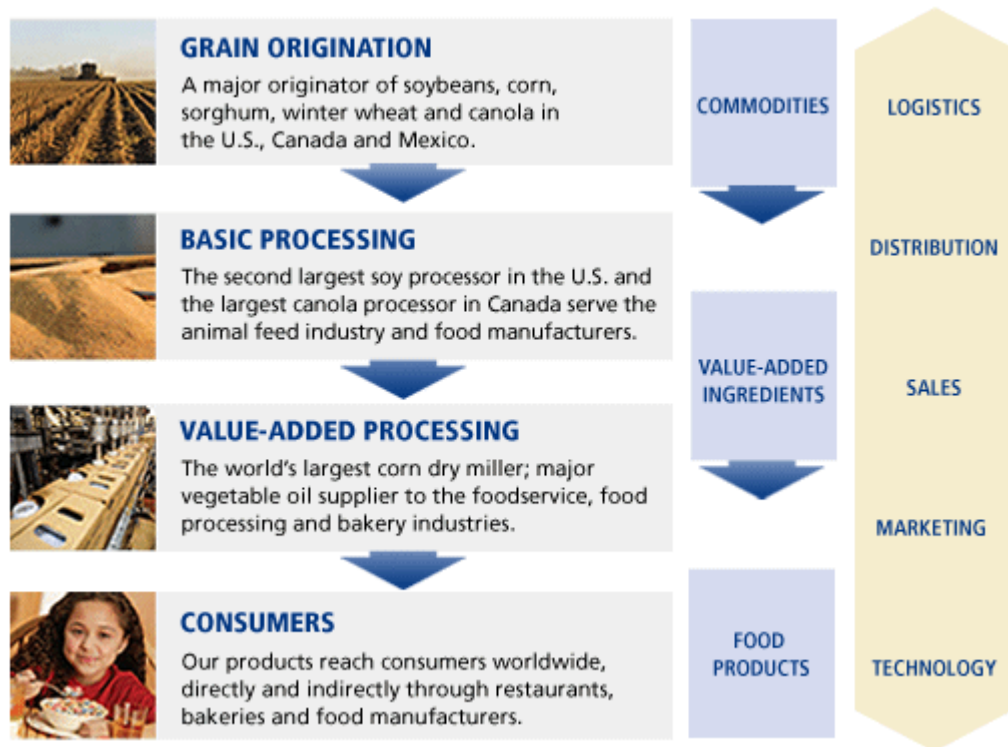
teacher told to business studies)
Specialisation makes firms interdependent

Mines -> Diamond Cutters & Wholesalers -> Sells diamonds
(Production Chain)

Why? Firstly doesn't have the skilled workers / secondly too expensive to do for the quantity of diamonds



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The work done at each stage is called **adding value**
 e.g. rough diamonds are not as valuable as polished diamonds
 Guy singing -> Studio -> Cds get produced -> Sold in shops

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Location of Production

1. Location of raw materials
2. Location of the market (Where the customers are)
3. Labour supply (Toys are made in China)
4. Transport and communication links (Factories in Penang -> Close to the port e.g. Pirate DVD exports to SE Asia)
5. Land and Premises (Factories in KL? Too expensive to build there)
6. Economies of concentration (Being near your competitors e.g. the publishing business are near to printers or to create a cluster where everybody goes to buy that product e.g. Low Yat Plaza)
7. Government Policy – Tax exemptions / low interest loans etc. e.g. Free trade area in Cyberjaya & KLCC
8. History and tradition – e.g. Royal Selangor Pewter
9. Industrial Inertia – High cost of relocation e.g. A microchip plant (Intel) or factory with specialist equipment like a car factory
10. Personal Reasons e.g. Managing Director wants to live next to the golf course
11. Climate

Methods of production

Job production – is making one thing at a time (Yachts , F1 cars , Selangor pewter).

Mass production – bread from the factories, iPhone, laptops, phones in general.(may use robots, assembly lines)

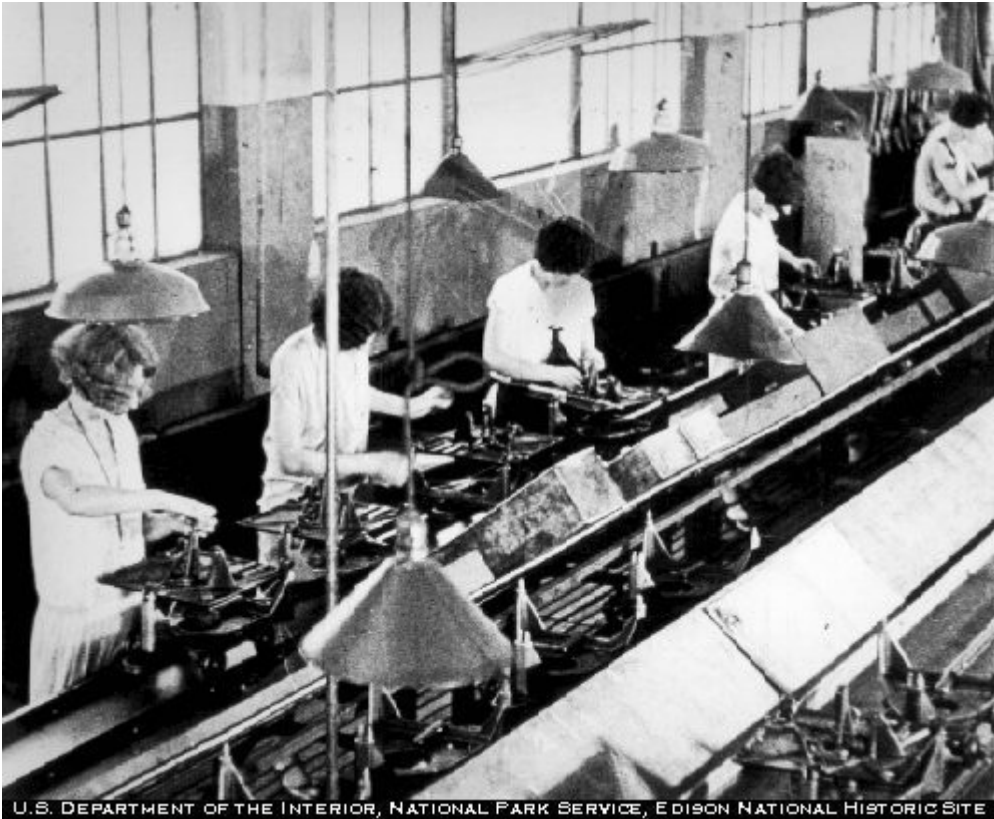
Batch production – a combination (lord of the rings- the ring, furniture, Easter eggs, building houses on a housing estate)

Organising production

Process layout – divide up production process into lots of parts. Each is carried out separately on a different part of the production floor e.g. complete step with all the products and then move onto the next step, carving all the wood products and then varnishing them.

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Production assembly lines – (mass production)



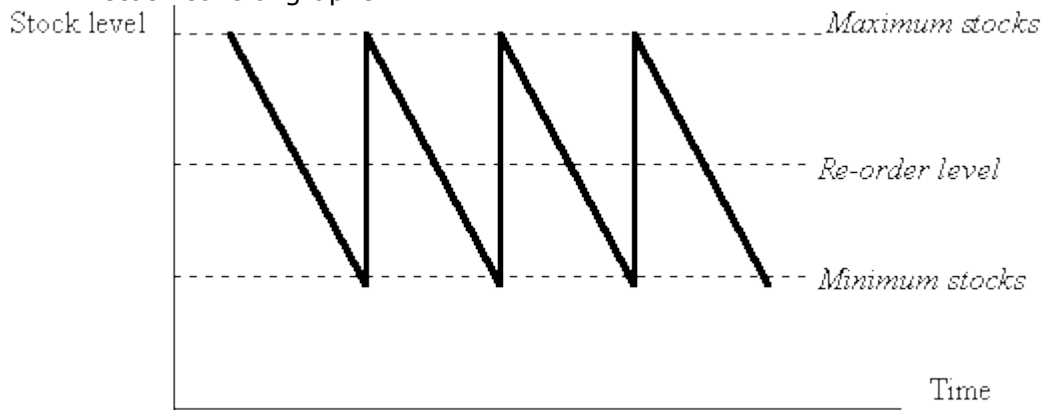
Team production – aimed to reduce worker boredom.

2. Group production – a team of workers are responsible for making the whole product. Need to be multi skilled.
3. Sell production – number of different tasks at a single stage of the process.

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Productivity and quality management

- Lean production – uses as few resources as possible (to keep the raw material, waste and stock to a minimum)
- stock control graphs



- Just in time – you keep stock levels to the bare minimum and stock should arrive immediately before it's used. This reduces cost of stock but there must be very good coordination between the firm and its suppliers. This is used a lot on the car industry.
- Just incase – buffer of stocks (extra stock available). Problem is that you may be left with stockpile. (lots of stock left in the factory) a publisher keeps a large stock of goods, just incase.
- Kanban – cards are used in each stage of the production so that employees can signal to each other when materials are needed.

Kaizen - Continuous improvement.

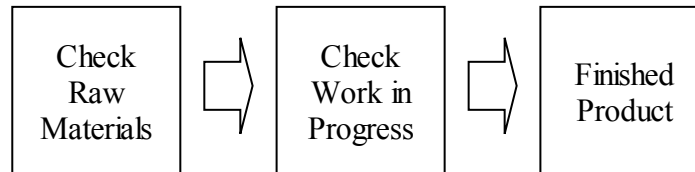
- Teams think of ways to improve efficiency

Rationalisation – Increase efficiency

- Closing admin departments.
- Closing smaller factories
- Reducing the number of managers
- Reducing the number of workers (This is bad news for some workers because it often results in redundancies)

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Key Point: Bad products lead to upset customers lead to no sales!



***At each stage check quality!
Cheaper to fix the sooner you spot the problem!***

Total Quality Management (Part of Kaizen)

Every employee in the company has an input into the quality and improvement cycle. The emphasis is on getting things right first time...

Quality Circles – Groups of employees from different departments get together to solve problems. A lot of emphasis on after-sales service and finding out what customers want.

Bad things: Takes a lot of employee commitment and can seem like extra work. Managers may see it as questioning their authority.

Statistical Process Control

Collect stats on production and compare it against other production plants. (Benchmarking)

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People

Workers

People work for different reasons –

- **Money**/salary, to secure a standard of living
- Job satisfaction – interesting work, good working conditions, convenient work hours, useful perks (company car) and good holidays.
- Do good for others include social workers, nurses and teachers.
- Meet people make friends and socialize.
- Self-confidence e.g. doctor, sergeant, architect, lawyer.
- Jobs give people an identity.

Skills and Attributes

Skills – IT programming, driving,

Attributes – personal qualities, patient and polite, eye for detail, strict, follow orders, shows leadership.

Recruitment and Contract of employment

1. Recruitment procedures must not **discriminate** against
 - b. Women - **Sex discrimination Act 1975**
 - c. Ethnic minorities (E.g. Indians, blacks and Chinese) - **Race Relations act 1976**
 - d. The disabled - **Disability Discrimination Act 1975**
2. All employees must receive a written contract of employment within one month of starting work. This is covered by the **employment rights Act 1996**
3. All employers must provide a **discipline procedure** (Written instructions) for all employees. Minor problems may receive a verbal (Speaking) or written warning. More serious offenses that are grounds for instant dismissal will be listed. This is covered by the **employment Protection Act of 1975**. (Laws)
4. The **1998 European Union Working Time Directive** (European law) limits the working week to 48 hours
5. Minimum Wage
 - Workers aged 22 and over: £5.52 an hour
 - Workers aged 18 to 21: £4.60 an hour
 - Workers aged 16 and 17: £3.40 an hour

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Anti discrimination law

Apart from recruitment the other main equal opportunities issue is pay. The 1970 Equal pay act says that an employee must be paid the same as another employee doing the same job. The act was intended to give men and women equal pay.

Men and women often do different jobs - so exact comparisons are difficult. The **1983 Equal Pay Act** made it compulsory to give the same pay for work of equal value. So a midwife supervisor should be paid the same as the other equivalent managerial jobs.

It is also illegal to discriminate against employees with disabilities.

Health and safety legislation

- The **1961 factories act** set the minimum requirements including toilets, washing facilities, lighting and fire escape.
- The **health and safety at work act of 1974** required all employers and their employees to take the responsibility for health and safety.
- The **1992 Workplace Regulations** introduced European Union rules including the same use of computers

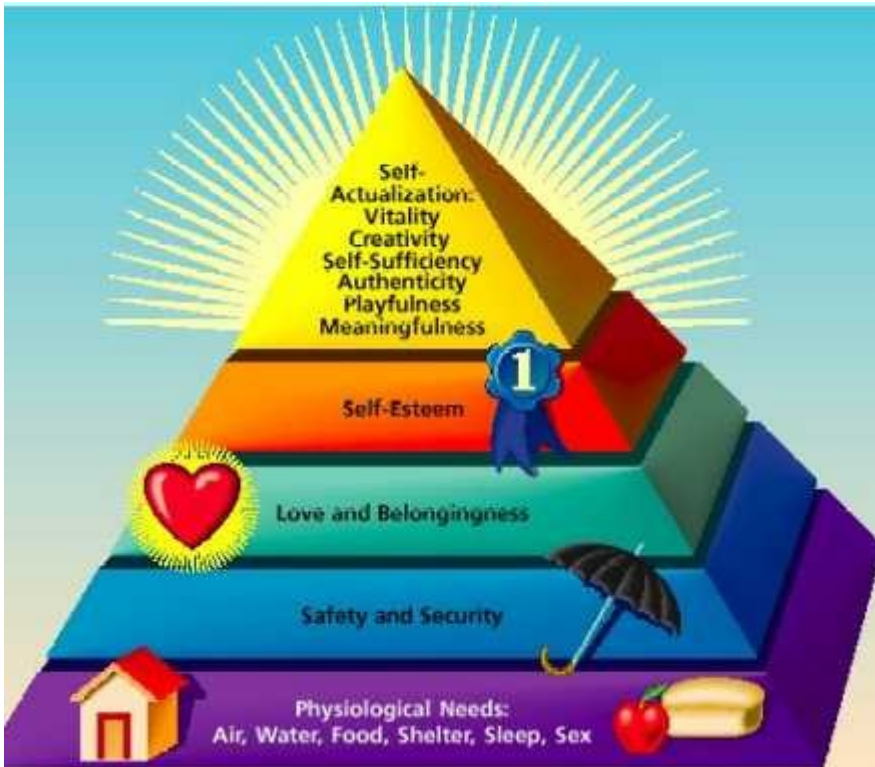
Leaving Employment

- The employment protection act 1978 protects employees against **unfair dismissal**. (Getting fired) They can only be dismissed if they are incapable of doing their job - like if they're incompetent or have shown gross misconduct. (Stealing from company or providing info to competitors)
- Employees can only be made **redundant** (Fired, but not your fault) if the job they are employed to do no longer exists - for example if there is a drop in demand, or automation. The firm cannot re-advertise a redundant job.
- Employees who think they can have been unfairly dismissed or made redundant can appeal to an **industrial tribunal**. (Like a court) The tribunal can award compensation or reinstate the employee.

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Motivation Theories

Maslow's Theory



You've got to climb past one before you care about the next....

Physiological needs – Water, food & a place to live (e.g. beggar on the street)

Safety and Security – Job security / actual safety e.g. working in a factory with knives and cutting tools or sales exec doing so much driving (e.g. factory workers)

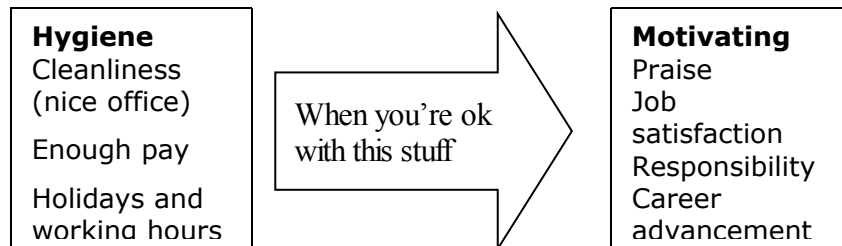
Love and Belonging – Enjoy the company of others (e.g. office work)

Self Esteem – Feel valued by others – Praise (e.g. Teachers / nurses)

Self-actualization - Achieving something (Making your TV Cabinet) (e.g. Architecture)

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Herzberg's Hygiene Factors



McGregor's Theory X and Theory Y



Theory X – Students are lazy, good for nothing and need a good whipping to get them to work....



Theory Y – Students will do work if it interesting and rewarding

Smart manager would use a combination according to the individual...

Financial Rewards

If people do more work they get more wages:

12. Time Rate – Paid per hour (e.g. Tuition) Encourages you to work slowly

13. Piece Rate – Paid per product (e.g. commission / author gets royalties) Encourages you to work quickly

This is a particular problem for Web & Graphic Design

...But a salary stays the same

Salaries are performance neutral (Year end bonus / Productivity bonus / company shares)

Salary + Commission – e.g. a diamond sales person

Fringe Benefits

Extras e.g. Company car / gym membership / golf club membership / free meals

Non-Financial Motivation

- **Job Rotation** – Changing jobs to keep it interesting
- **Job Enlargement** – Giving people more work to do – Good greater variety / Bad more work

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- **Job Enrichment** – Better things to do (Might supervise other workers, given less of the tedious tasks)

Kaizen – He’s back....Let them take decisions

Management Styles

- Authoritarian / Autocratic Style – Follow orders
- Paternalistic – Fatherly style, some consultation
- Democratic – Discuss issues / may vote on things and delegate responsibility (Team is good)
- Laissez-Faire Style – Manager trusts the employees to make decisions. (The manager does not have the skills of the employees)

Delegation

Advantages

- Motivates employees (Because in charge of their own destiny)
- Saves the manager’s time
- Speeds up decision making (Employee empowerment)

Disadvantages

8. Employees are also free to make mistakes
9. Managers need to check what’s being done
10. Too much given to people who don’t have enough experience

Business

Basic Financial Terms

Turnover / Sales Revenue

Money you get from sales

Fixed Costs

Costs that stay the same and don't change with production or sales

14. Wages and Salaries – What you pay people
15. Rent and Rates – Price of your shop
16. Office expenses – Stationery, cleaning etc
17. Advertising – TV / Radio / Newspaper etc adverts
18. Depreciation – Assets that lose value (Like cars and computers)
19. Misc Expenses – Miscellaneous expenses (Bits and pieces)

Variable Costs

Costs that change with production and/or sales

- Purchases – Ready made things you buy
- Raw Materials – Basic things you buy for manufacture
- **Wages** – Some wages are variable costs

Stock – Stuff in the warehouse

Opening stock – Stock you start off with

Closing stock – Stock you are left with at the end of the year

Fixed Assets

Things that the business keeps for more than a year

Premises – Place you own or lease

Machinery – Tools for making products

Vehicles – Cars / Vans etc

Current Assets

Stuff you've got that you can get money from next year.

Stock	Least liquid
Debtors – People that owe you money	
Cash – Money (in the bank)	Most liquid

Liquidity is the ease with which you can convert it into cash!

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Current Liabilities

Money you have to pay next year

- Creditors – People you owe money to
- Unpaid corporation tax – Tax that hasn't been paid.

Financed By

Share capital – Money raised from shares

Retained Profit and Reserves – Profits that you keep

Long-term Liabilities

Money you have to pay back in more than 1 year.

Bank Loan – Money you borrow from the bank

Debentures – Limited companies can borrow from the general public. (Advantage is that there are no middle men)

Other Payments

6. Interest Payable – Interest paid to the bank
7. Taxation – Money to the government
8. Dividends – Money to Shareholders

Straight Line Vs Reducing Balance?

Straight Line is ideal if you are going to throw away the asset after use and then replace it.

E.g. Furniture / tools

Reducing Balance is more difficult to calculate, but can take into account sales value. E.g. Cars / Computers

Cashflow – Why Forecast?

YOUR CREDITORS CAN CLOSE YOUR BUSINESS! (Bankruptcy)

When you are desperate it is more difficult to borrow money!

So you must plan your cashflow!

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Sources of Finance

Internally

- Retained Profits
- Chase up creditors (People who owe you money)
- Sell Fixed Assets
- Run Down Stocks (Don't replace stocks)
- Re-invest Savings (Only larger companies can do this)

External

Short Term

- Personal Savings
- Friends and Family
- Overdraft (Higher interest rate)
- Pay creditors as late as possible (Bad reputation)
- Debt Factoring agency – Collect your debts and give you a percentage 90%

(Used in emergencies)

Medium Term

11. Bank Loan
12. Lease fixed assets (Like renting)
13. Hire Purchase (Rent it, but you then own it)
14. Grants from EU, Government and local authorities. Don't have to repay, but application process is long and complicated.

Long Term

- Mortgage (Loan for premises)
- Issue more shares (Only available to Ltd companies)
- Issue debentures (Long term loans to the public)

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Business Growth

Business Plans

1. Personal Details of the owner and other important personnel – CV's
2. Mission Statement – Broad aims of the company
e.g. "To be the number 1 Website in SouthEast Asia"
3. Objectives – These are quantified and specific
e.g. To average 10,000 hits per day.
4. Product Description – 4P's
5. Production Details
6. Staffing Requirements
7. Finance

Help Starting

- The Government – Business Link provides advice & government backed loans
- Banks – Loan money and provide banking services
- Charities – Provide money, e.g. Prince's Youth Trust
- Chamber of Commerce - Information and support

Why Grow?

- Economies of scale
- Diversification
- Financial Support
- Personal vanity
- Domination of the market

Four Main Methods of Internal Expansion

- Produce more of the same products for existing markets
- Line Extension – Produce different products for existing markets
- Can sell its current products into new markets
- Diversification – Sell new products into new markets

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Takeovers and Mergers

A takeover is when one company buys another and a merger is when they both agree to join.

- Horizontal Integration – Two competitors join together
- Forward Vertical Integration – When a company takes over its customer
- Backward Vertical Integration – When a company takes over its supplier
- Lateral / Conglomerate Integration – Takes over a company in another market

Internal Economies of Scale

- Purchasing economies
- Marketing economies
- Managerial economies
- Financial economies
- Technical economies
- Risk-bearing economies (Selling to many different markets to reduce risk)

External Economies of Scale

- Suppliers locate near customers
- Local workforce with the right skills
- Support from Government
- Build up a good reputation for particular products

Disadvantages of Growth

- Decisions can take time
- More difficult to manage information
- Workers at the bottom of the ladder can feel insignificant

Communication

Written

Includes: Emails, faxes, letters, memos and notices

Advantages: Permanent record, people can read it again and it can be distributed to a large number of people

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Disadvantages: Feedback can be difficult to obtain.

Verbal

Includes: Telephone calls, one-to-one conversations, group meetings or video conferencing

Advantages: Information can be given quickly, body language can be read and feedback can be easily obtained

Disadvantages: No permanent record and sometimes people forget what they have been told

Visual

Includes: Films, posters, diagrams and charts

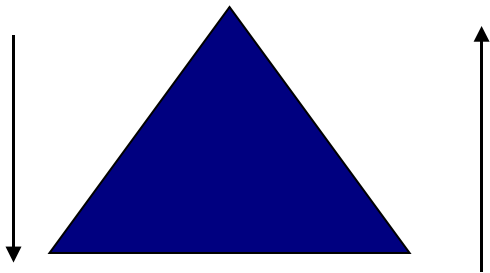
Advantages: Can communicate emotions, summarise ideas and can be distributed quickly

Disadvantage: feedback can be difficult, can be interpreted in different ways and could be costly

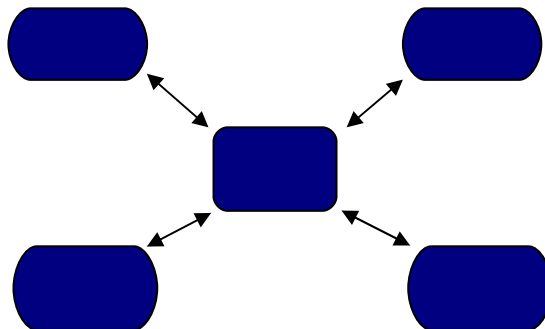
Business

Business Structures

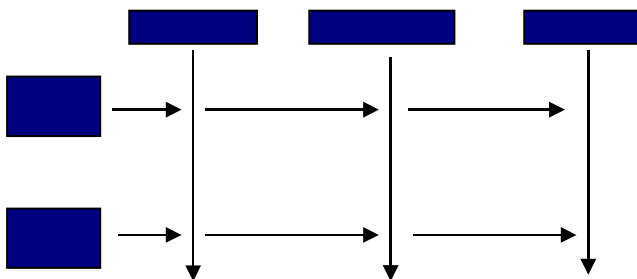
The Pyramid



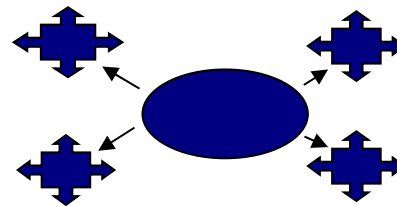
Entrepreneurial



Matrix



Independent



Going Multinational

Reasons to go international

- Keep transport costs down
- Increase knowledge of local market conditions
- Avoid trade barriers
- Reduce foreign currency risks
- Access cheap raw materials and labour
- Avoid taxes
- Win subsidies from Governments

Business

Competition

Producers want a monopoly – To be the only producer of that good.

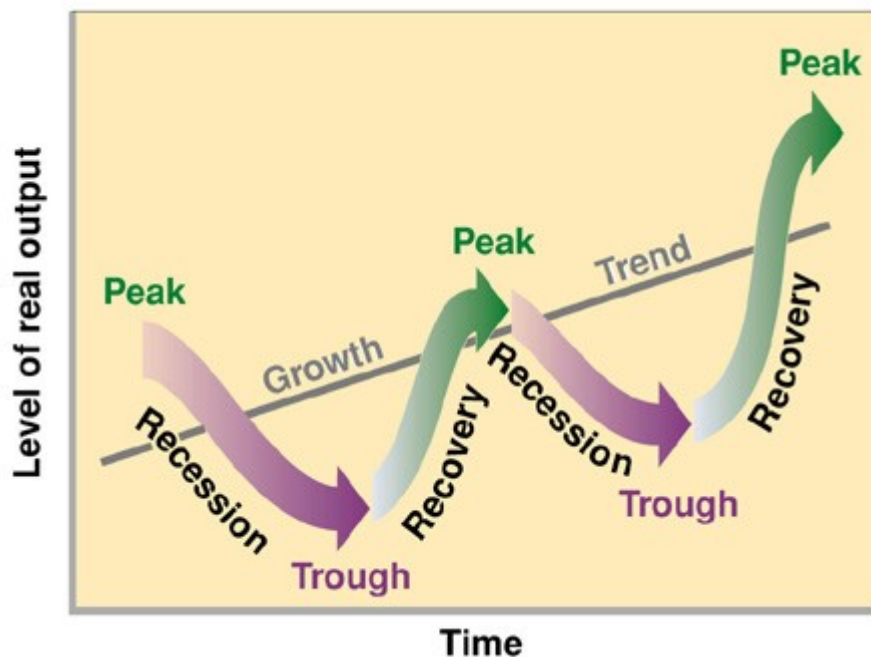
Consumers want perfect competition – Many suppliers competing against each other

Oligopoly is somewhere in between

Business

External Influences

The Business Cycle



Economic growth is measured through – Gross Domestic Product (GDP)

Unemployment

In the United Kingdom one and half million people want a job, but cannot get one. There are four main reasons for unemployment:

Cyclical

People are not buying enough British goods and services to employ the available workforce.

Technological

The people seeking work do not have the skills wanted by potential employers.

Structural

The unemployed have the skills required by employers but they live in the wrong place and are not able to move.

Frictional

Short term unemployment: people who are between jobs.

Business

Inflation

Twenty years ago, the British pound was worth twice as much. For example, in 1979 a Mars Bar cost about 15p while today it costs around 30p. This rise in price is due to **inflation**. An increase in pay that takes into account inflation is described as being 'in real terms'. For example, if pay increased by 5% last year but inflation was 2%, the pay increase would be: $5\% - 2\% = 3\%$ 'in real terms'.

What causes inflation?

- Too many people trying to buy too few products results in price increases.
- People asking for high pay rises can lead to companies raising prices.
- The **Government spending** more than it receives from taxes so prints more money to increase the money supply (**Monetary Policy**).

How does inflation affect people?

You want to buy a hi-fi that costs £100. You can borrow £100 agreeing to pay 15% interest over the year. This means the total cost of the hi-fi will be £115. Another solution is to save for a year until you have the required amount. Taking inflation of 3% into account which is the better solution for you?

Borrower

You will have paid £115 for something which costs £100 at the time of purchase. With inflation at 3% the hi-fi would not normally cost £115 until 5 years later.

Saver

If you had put £100 in the bank with a 10% interest rate you would have ended up with £110 after a year. Due to inflation of 3% the hi-fi will now cost £103 and you will have made a profit of £7 but at the expense of not having a hi-fi for a year. If it is possible to not use a hi-fi for a year then this would be the best solution.

How does inflation affect businesses?

Exporters lose out from inflation. If prices rise faster in Britain than in other countries our goods will be too expensive for buyers abroad.

Business

Economics effects of exchange rate changes

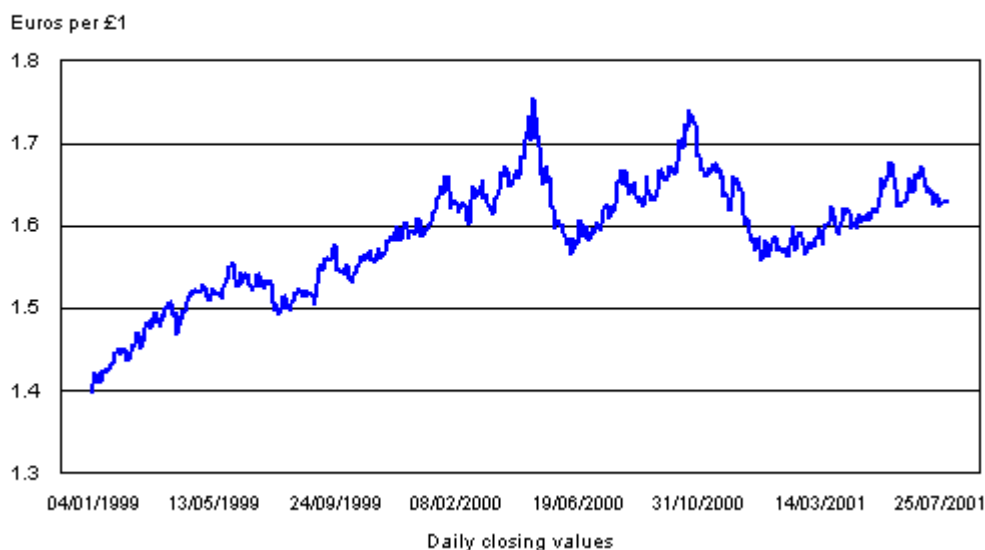
Changes in the exchange rate can have a powerful effect on the economy - but these effects take time to show through. There are time lags between a rise or a fall in the exchange rate, and changes in variables such as inflation, GDP and exports & imports.

Much depends on

- The scale/size of any change in the exchange rate
- Whether the change in the currency is short term or long term
- How businesses and consumers respond to exchange rate fluctuations

WINNERS AND LOSERS FROM EXCHANGE RATE FLUCTUATIONS

STERLING AGAINST THE EURO



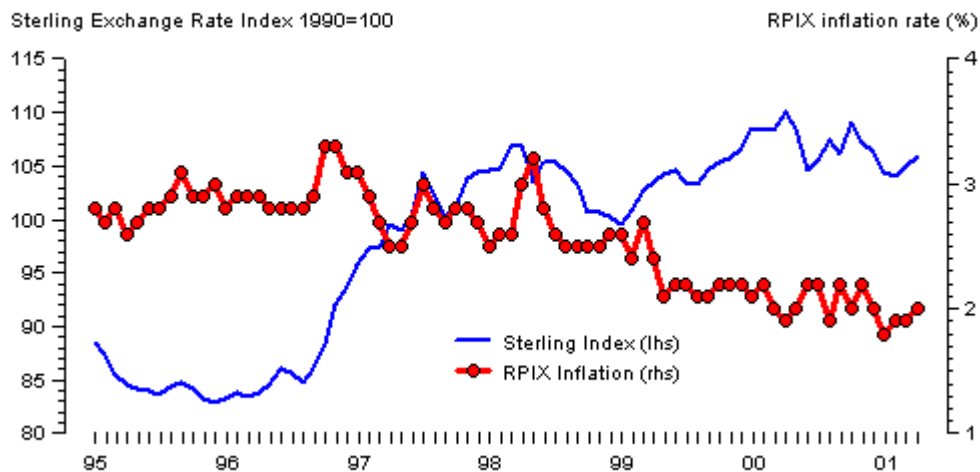
In recent years the sterling exchange rate has risen appreciably against a range of other leading currencies - not least the Euro since its inception in January 1999. Who are the main gainers and losers from a rising exchange rate?

An appreciation of the exchange rate has economic consequences both in the short and long term. As the economy adjusts to a higher exchange rate, some of the main beneficiaries and losers start to emerge. But textbook economics does not always provide clear cut answers to this question:

Business

Advantages of a strong pound

THE STRONG POUND KEEPS INFLATION UNDER CONTROL



A high pound leads to lower import prices - this boosts the real living standards of consumers at least in the short run - for example an increase in the real purchasing power of UK residents when traveling overseas

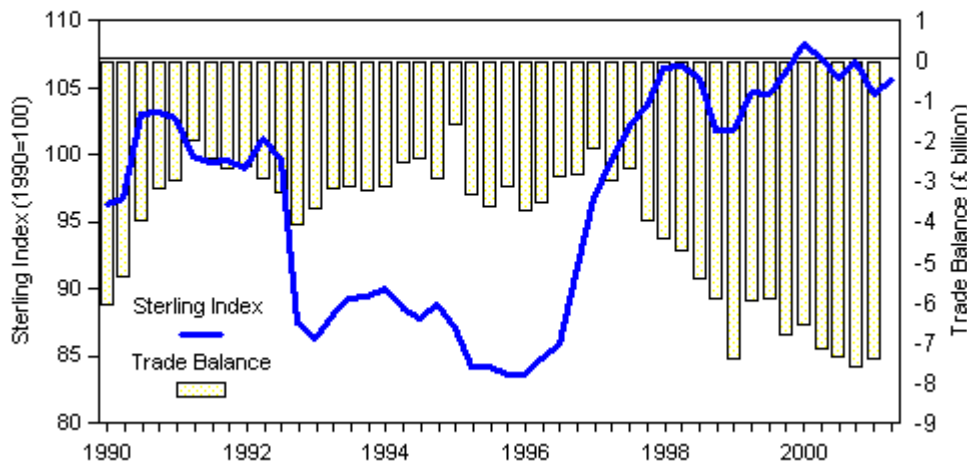
When sterling is strong, it is cheaper to import raw materials, components and capital inputs - good news for businesses that rely on imported components or who are wishing to increase their investment of new technology from overseas countries.

A strong exchange rate helps to control inflation - domestic producers face stiff international competition from cheaper imports and will look to cut their costs accordingly. Cheaper prices of imported foodstuffs etc. will also have a negative effect on the rate of consumer price inflation.

Business

Disadvantages of a strong pound

STERLING EXCHANGE AND THE BALANCE OF TRADE IN GOODS



Cheaper imports leads to rising import penetration and larger trade deficit e.g. the £28bn trade deficit in goods in 2000

Exporters lose price competitiveness and market share - this damages profits and employment in some sectors - notably manufacturing industry in the last three years

If exports fall, this has a negative impact on economic growth. Some regions are affected more than others. The strength of sterling in the last five years is one of the factors highlighted when economists analyse the north-south economic divide in the UK

Many business organisations have identified the strength of the exchange rate as a major economic problem over recent times.

Economists working for the ITEM club argued in the summer of 2001 that the pound should be lower by at least 10% in order to prevent manufacturing industry falling into an economic slump.

However it should be noted that business can adapt to a high exchange rate. There are ways in which industries can adjust to the competitive pressures that a strong pound imposes. Some of the options include:

- Cutting export prices (lower profit margins) to maintain competitiveness and market share
- Out-sourcing components and raw materials from overseas
- Seeking productivity / efficiency gains to keep unit labour costs under control
- Investing resources in new product lines where both domestic and overseas demand is more price inelastic and less sensitive to exchange rate fluctuations. This involves producing products with a higher income elasticity of demand, where non-price factors are more important in securing orders.
- Moving production overseas

Business

Restricting Imports

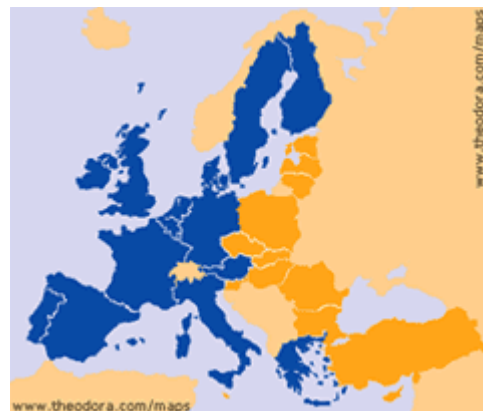
- Quotas – Directly limit the number of items allowed in
- Tariffs – Add taxes to imports
- Subsidies – Subsidize locally made products
- Product Safety Standards
- Government Buying policy – The Government can use its own buying power to buy locally.

The EU

The European Union (EU) is the organisation which integrates the countries listed below, both politically and economically. It is a **customs union**, which is an agreement amongst a group of countries to eliminate trade barriers between them on the movement of goods, services, labour and capital, and also to establish a common external tariff on goods and services coming into the union. The EU evolved from the European Coal and Steel Community (ECSC), which was formed in 1951 as a response to the First and Second World Wars to try to ensure future peace in Europe. This became the European Economic Community (EEC) in 1965, which in turn became the European Union in 1992 following the signing of the Maastricht Treaty.



1950 - Belgium, Germany, France, Italy, Luxembourg and the Netherlands agree to form the ECSC.



2004 - The EU consists of 25 Member States, as 10 New Member States joined in May. Bulgaria, Romania and Turkey currently hold applicant status.

Maps courtesy of www.theodora.com/maps used with permission.

Member States

The EU has 25 Member States. These are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, the United Kingdom and the 'New Member States' which joined in May 2004.

New Member States

The EU has 10 New Member States which became full members on 1st May 2004. These are Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and

Business

Slovenia.

Applicant Countries

There are two countries that are currently negotiating to join the EU by 2007. These are Bulgaria and Romania.

Turkey made an application for membership in 1987, but is not currently negotiating its membership.

Croatia and Macedonia have also applied to join the EU.

Guide to EU Institutions

The three main **political** EU institutions are:

- The **European Parliament** is directly elected by citizens of the EU who are represented by Members of the European Parliament (MEPs). There are 626 MEPs, 87 of whom are British. The Parliament makes decisions on legislation and the budget of the EU.
- The **Council of the European Union** is the main decision making body. Together with Parliament, it has the power to make decisions on legislation and the budget of the EU. The Council is also known as the Council of Ministers as a government Minister from each member state attends the Council. The Minister attending varies according to the subject under discussion. For instance, Margaret Beckett, currently Secretary of State for Environment, Food & Rural Affairs, represents the UK at the Agriculture and Fisheries and Environment Councils.
- The **European Commission** proposes legislation to and implements the decisions of the Council and Parliament. It is the civil service institution of the EU. There are twenty Commissioners, two of whom are from the UK - Chris Patten and Neil Kinnock. The President of the Commission is Romano Prodi.
-



The two main **financial** institutions are:

- The **European Central Bank** manages the euro, the currency used by 12 of the EU's 15 member states. The Bank sets interest rates for these 12 countries and conducts foreign exchange operations. It also maintains price stability in the euro area by controlling the money supply and monitoring price trends.
- The **European Investment Bank** finances investment projects that promote the objectives of the integration, balanced development and economic and social cohesion of Member States. The Bank raises money on the financial markets, rather than using EU funds. Examples of the Bank's projects range from the building of Phase 3 of the Manchester Metrolink to the upgrading of 100 schools in Bucharest, Romania.



Business

The EU budget

How is the EU funded?

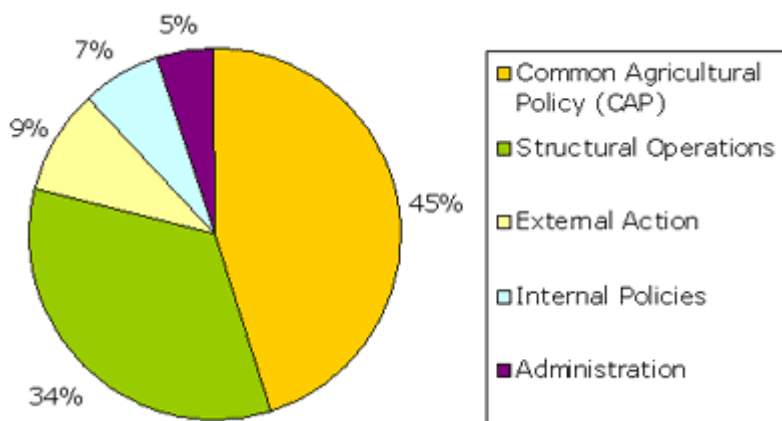
The EU is funded from four sources of revenue. These sources were set out in what is known as the 'Own Resources Decision', which ensured that the EU has automatic sources of revenue. Each Member State must pay the following:

- **Customs duties.** These are derived from tariffs applied to imports from countries outside the EU. Member states may retain 25% of customs duties to take into account the costs of collection.
- **Agricultural levies.** These are charged on agricultural imports from countries outside the EU. Member states may retain 25% of customs duties to take into account the costs of collection.
- **VAT-based contributions.** These are levied at 0.75% in 2002 and 2003, then 0.5% thereafter.
- **Contributions based on Gross National Product (GNP).** This is set at 1.02% for the 2003 budget.

How is the money spent?

The EU has committed itself to spending just under 100 billion euro in 2003. This budget will be split as follows:

- 45% on the Common Agricultural Policy (CAP)
- 34% on Structural Operations (this redistributes wealth from the richer countries to the poorer ones via the EU's regional policy)
- 9% on External Action (this includes overseas development aid and disaster relief)
- 7% on Internal Policies (this includes research and development, energy, transport networks and education and training)
- 5% on Administration



Business

Appendix 1 – Example Figures

Balance Sheet and Profit and Loss Account

Balance Sheet				Trading, Profit and Loss Account		
James' Computer Games Ltd, 31 March 2007				James' Computer Games Ltd		
				Year Ending 31st March 2007		
	£000	£000	£000		£000	£000
Fixed Assets				Turnover		180
Premises			80	Cost of sales:		
Machinery			40	Opening Stock	3	
Vehicles			30	Purchases	15	
			<u>150</u>		<u>18</u>	
Current Assets				Minus Closing Stock	5	
Stock at 31 March 2007		5		Cost of sales =		13
Debtors		12		Gross Profit =		<u>167</u>
Cash		3		Minus Expenses		
		<u>20</u>		Wages and Salaries	93	
Current Liabilities				Rent and rates	10	
Creditors	14			Office expenses	28	
Unpaid Corporation Tax	1			Advertising	5	
		<u>15</u>		Depreciation	8	
Net Current Assets (Working Capital)			5	Other Expenses	3	
Net Assets			<u><u>155</u></u>	Expenses		<u>147</u>
Financed by				Operating Profit		<u>20</u>
Shareholders Funds				Interest Payable		<u>2</u>
Share Capital			80	Profit before tax (Net Profit)		<u>18</u>
Retained Profit and Reserves			50	Taxation		3
Long-Term Liabilities				Dividends		9
Bank Loan			20	Retained Profit		6
Debentures			5			
Capital Employed			<u><u>155</u></u>			

Business

Ratio Analysis

Profitability Ratios

Gross Profit Margin	= gross profit	/ sales		Gross Profit Margin and Net Profit margin should be used together when investing.
	93%	167	180	
Net Profit Margin	= net profit	/ sales		
	10%	18	180	

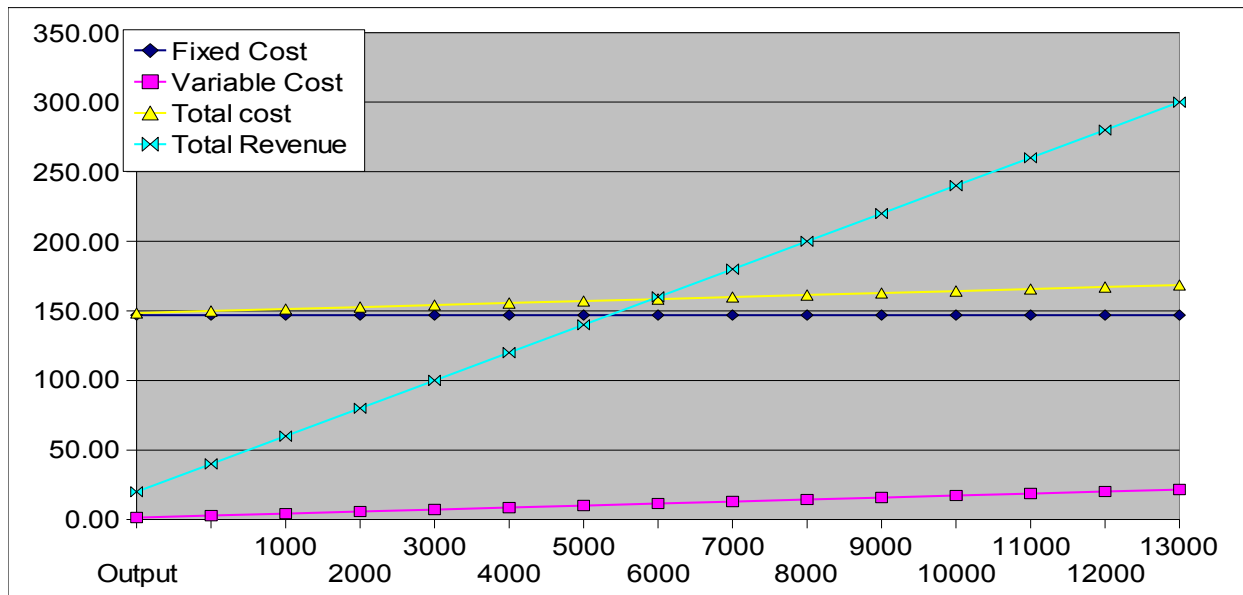
Return on Capital Employed (ROCE)	=net profit	/ capital employed		This is the key figure for investors Investors should also consider the risk of the business
	12%	18	155	

Liquidity Ratios

Current Ratio	=current assets	/current liabilities		Ideally this figure should be around 1.5
	1.33	20	15	
Acid Test Ratio	=current assets	- stock	/ current liabilities	Ideally this figure should be about 1
	1.00	20	5 15	

Business

Breakeven Chart



Breakeven Chart

Output	Fixed Cost £000	Variable Cost £000	Total cost £000	Total Revenue £000
1000	147	1.44	148.44	20
2000	147	2.88	149.88	40
3000	147	4.32	151.32	60
4000	147	5.76	152.76	80
5000	147	7.20	154.20	100
6000	147	8.64	155.64	120
7000	147	10.08	157.08	140
8000	147	11.52	158.52	160
9000	147	12.96	159.96	180
10000	147	14.40	161.40	200
11000	147	15.84	162.84	220
12000	147	17.28	164.28	240
13000	147	18.72	165.72	260
14000	147	20.16	167.16	280
15000	147	21.60	168.60	300

Breakeven Point

Contribution per unit = selling price - variable cost		
18.56	20	1.44
Breakeven point = Fixed Costs / Contribution per unit		
7920.26	147000	18.56

Business

Cash Flow Forecast

	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Total Receipts (Cash inflow)	15	13	12	12	12	17	19	22	24	12	12	15
Total spending (cash outflow)	13.33	13.19	13.12	13.12	13.12	13.48	13.62	13.84	13.98	13.12	13.12	13.33
Bank Balance at start of month	3	4.67	4.48	3.36	2.24	1.13	4.65	10.03	18.19	28.21	27.09	25.97
Bank Balance at end of month	4.67	4.48	3.36	2.24	1.13	4.65	10.03	18.19	28.21	27.09	25.97	27.64

Depreciation

	Straight Line Method		Reducing Balance Method		
			%	Value	Dep
Cost	40000			40000	
Year 1	32000	25	30000	10000	
Year 2	24000	20	24000	6000	
Year 3	16000	30	16800	7200	
Year 4	8000	50	8400	8400	
Year 5	0	90	840	7560	
Reduces value by a fixed amount	Amount: 8000		Reduces value by a percentage each year		

Budget

James' Computer Games

Budget for 2007 £000

	Forecast	Actual	Variance
Sales Revenue	200	180	-20 unfavourable
Purchases	14	13	1 favourable
Wages and Salaries	92	93	-1 unfavourable
Rent and rates	11	10	1 favourable
Office expenses	30	28	2 favourable
Advertising	5	5	0 unfavourable
Depreciation	9	8	1 favourable
Other Expenses	2	3	-1 unfavourable