

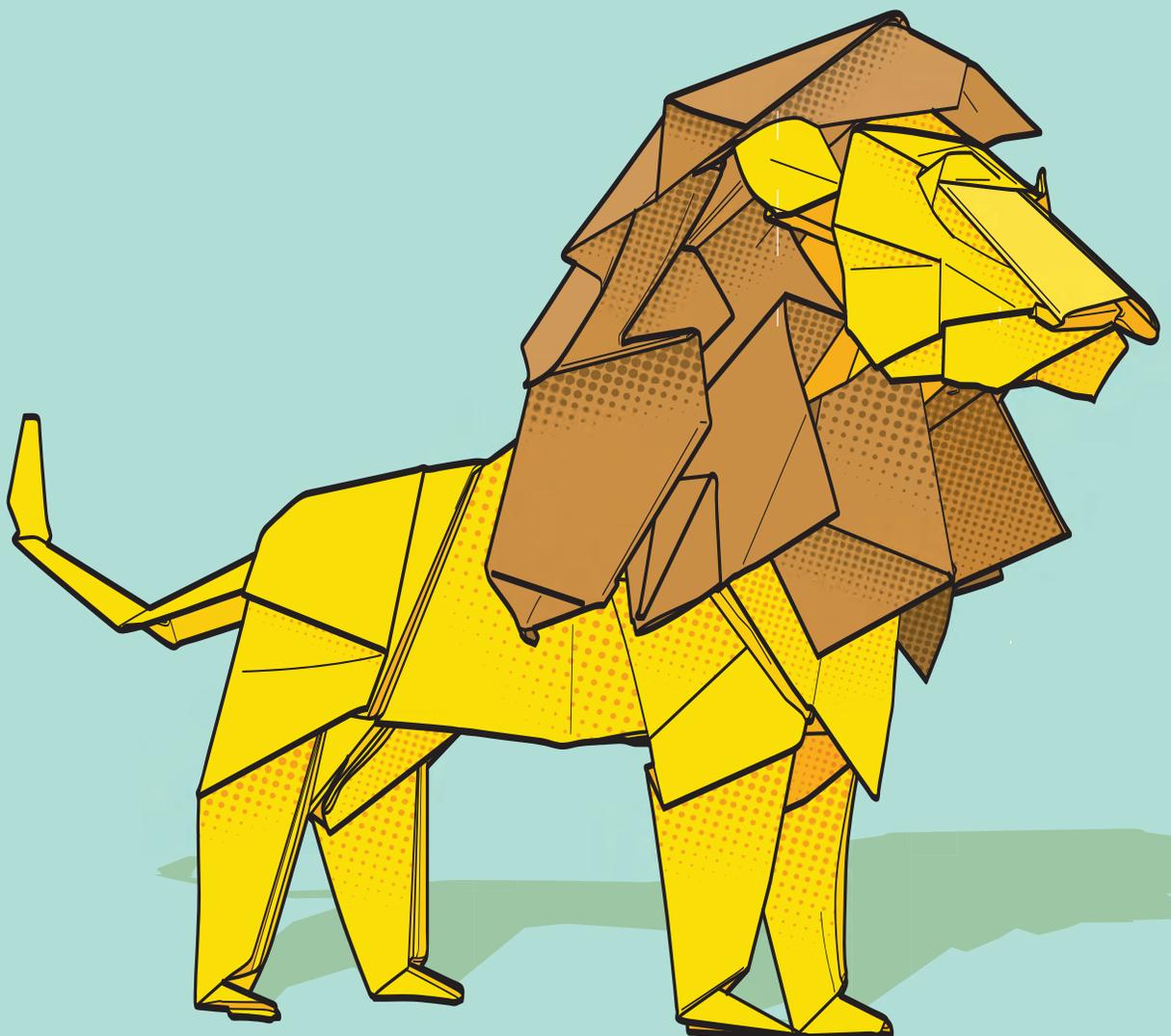


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**Pearson Edexcel GCSE (9–1)**

# **Business**

**Revision Guide + App**



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**Business****REVISION  
GUIDE**

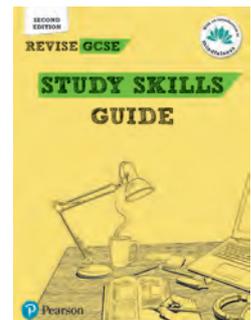
Series Consultant: Harry Smith

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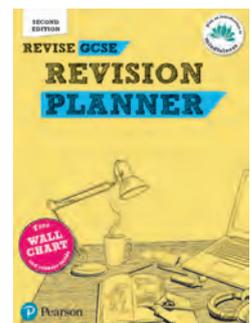
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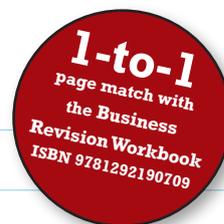
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Target  
grade  
**4**

**Question difficulty**

Look at this scale next to each exam-style question. It tells you how difficult the question is.



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Pearson Edexcel publishes Sample Assessment Material and the Specification on its website. This is the official content and this book should be used in conjunction with it. The questions in Now try this have been written to help you practise every topic in the book. Remember: the real exam questions may not look like this.

**Terms in blue** can be found in a glossary on page 93.

Had a look Nearly there Nailed it! Investigating  
small businessEnterprise and  
entrepreneurship

# The dynamic nature of business

Businesses operate in dynamic markets. New opportunities arise and new businesses and business ideas are created. Wherever there is a need for a product or service, an **entrepreneur** may take the chance to meet that need with a new business venture.

## Changing technology

As new technology develops, new business opportunities arise. New technology can often improve products and services, and make them more desirable in a number of ways. New technology can:

- make products and services **faster**
- make products **smaller** (more compact)
- make products and services **cheaper**
- make products and services **easier to use**
- make products **safer**.

## Changing consumer needs

Society is constantly changing. These changes lead to **consumers** spending their money in different ways. New business opportunities can arise because of new consumer wants and needs caused by:

- changes in **fashions**
- changes in the **economy**
- changes in **national demographics**
- changes in **lifestyle**, such as the way consumers spend their leisure time
- changes in **technology**.

## Obsolescence

The introduction of new technology and the changing nature of consumer needs means that products and services can become **obsolete** very quickly. Many products are designed to only last a short time, and consumers are encouraged to buy newer and improved versions of these products. This is called **planned obsolescence**.



Digital music downloads are an example of how new technology makes products and services obsolete. Physical CD sales in the USA dropped by more than 75% between 2005 and 2014.

## Worked example

Target grade **2**

Give **two** examples of the way in which new business ideas can be generated. (2 marks)

- 1 A new idea, such as a new invention.
- 2 Developed from existing ideas, such as by making slight changes and improvements to an existing product or service (innovation).

A new business venture can be **unique** (the only one of its kind) or similar to other existing ideas.

Level of uniqueness:  
Left highly unique  
Right generic business

← Unoccupied gap in the market

Entrepreneur thinks they can do it better

→ Market big enough for another competitor

## Now try this

Target grade

**4**

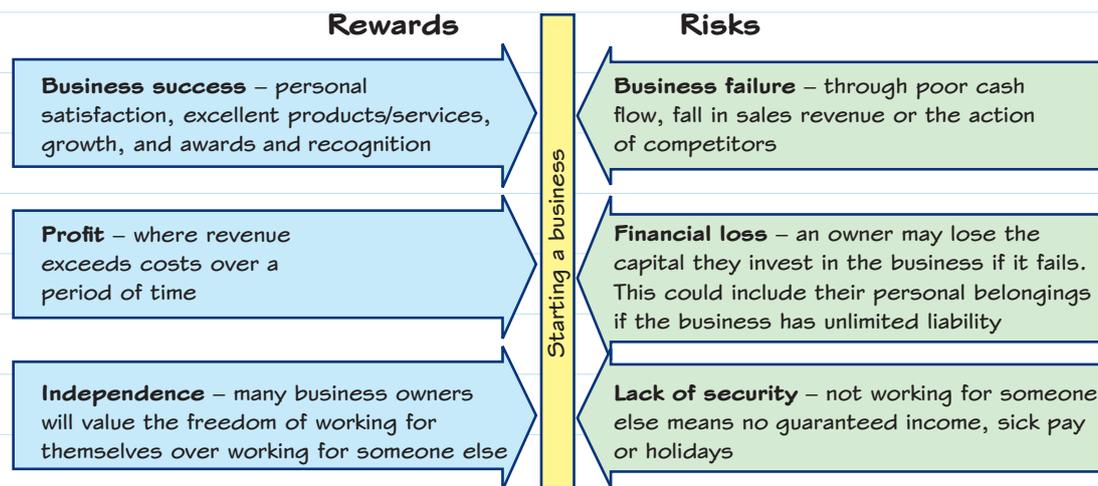
- 1 Explain **one** opportunity that the introduction of new technology creates for a business. (3 marks)
- 2 Explain **one** way in which a gap in the market creates a business opportunity. (3 marks)

# Risk and reward

Before an entrepreneur starts their own business or sets up their own company, they will consider the **risks** and **rewards** associated with their business venture. Some businesses may be considered higher risk than others, but they may also offer greater rewards to their owners.

## Working out the risk

Risk is worked out by considering the **probability** of a negative outcome occurring and the **impact** of the negative outcome. Starting any business will involve taking a risk because there are so many **unknown factors** that affect long-term business success.



There are both rewards and risks associated with starting a business.

## How can risk be reduced?

- Carry out detailed **market research** (you can revise market research on page 8).
- Produce a **business plan** (you can revise business plans on pages 31–32).
- Ensure that the business is **competitive** (you can revise competition on pages 13–14).
- Raise sufficient **start-up finance** (you can revise finance on pages 23–24).

## What makes some businesses riskier than others?

- Seasonal demand, such as for ice cream.
- A small market.
- A highly competitive market with lots of competitors.
- An owner who knows little about the product or market.

## Worked example

Target grade 3

Sonia Fletcher set up as a sole trader selling cakes made from organic ingredients. Which **one** of the following is an example of a risk for Sonia's business?

Select **one** answer:

- A Sonia has estimated that demand will rise over the next six months
- B Sonia has calculated a negative cash flow for August
- C Sonia is anticipating that the cost of flour will fall next year
- D Sonia has estimated that she will need to work an extra 5 hours per week to meet demand for her products

(1 mark)

Consider the factors that could lead to business failure. Although Option D might be a personal downside for Sonia, it is not likely to cause business failure. Option B is the correct answer as it is a risk for the business.

## Now try this

Target grade 4

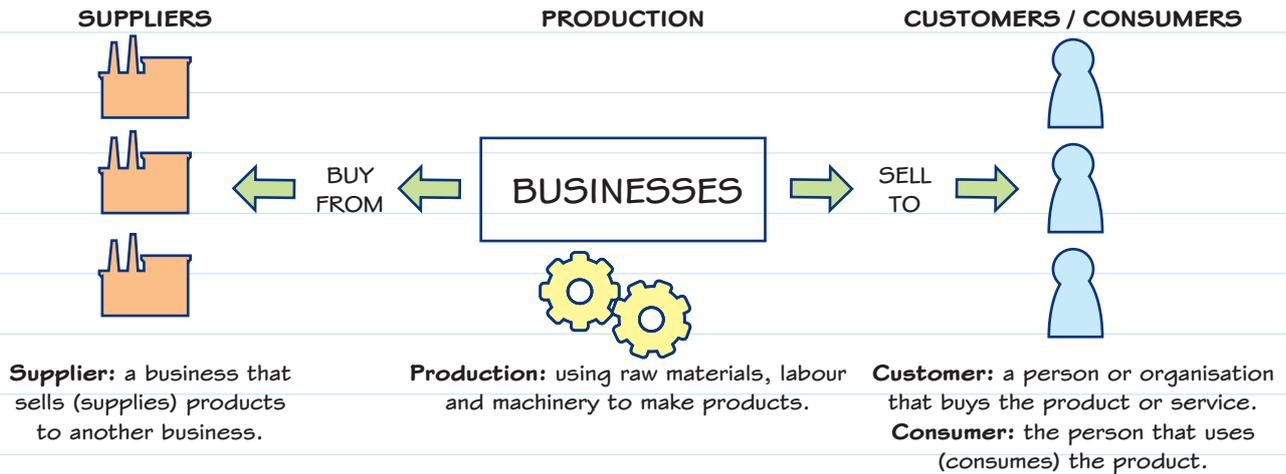
Explain **one** reason why someone might want to set up their own business.

(3 marks)

# The role of business enterprise

A **business** or **enterprise** is a person or organisation with the **purpose** of producing goods and services to meet the needs of customers. A business might produce its own goods or buy them from a supplier and sell them to **customers**.

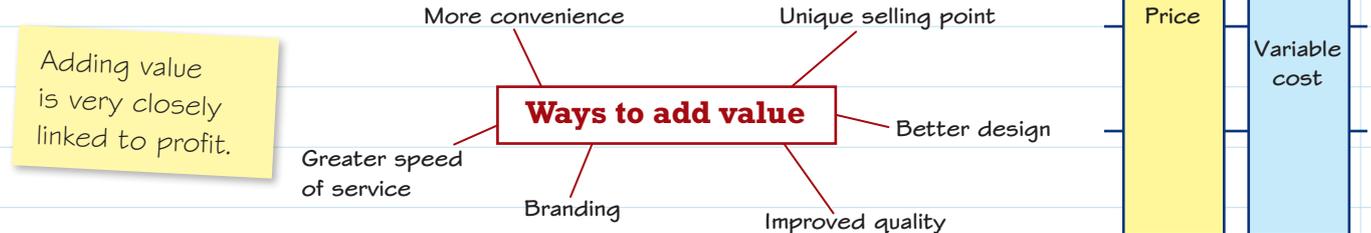
## What businesses do



The purpose of all products and services is to meet the needs of customers, often in order to make a **profit**.

## Adding value

Successful businesses will be able to **add value** to their products and services. A business can add value to its product by lowering variable costs or adding something that will make customers willing to pay a higher price.



## Worked example

Target grade 6

Which **two** of the following might be the best ways in which an oven-cleaning business could add value to its products?  
 Select **two** answers: (2 marks)

- A Employing an accountant to manage cash flow
- B Offering free after-care visits to check customer satisfaction
- C Making sure they have an excellent relationship with the bank
- D Buying a van with the name of the company clearly written on the side
- E Providing a weekend service so that customers do not need time off work

B and E are things that customers would be willing to pay more for. Option B would provide a better all-round service, and Option E would improve convenience. The other three options might improve the business but would not **add value**.

## Now try this

Target grade 6

Discuss why a business may find it difficult to add value to its products or services. (6 marks)

# The importance of added value

Adding value is important to a business for a number of reasons. A business must decide how best to combine the features of its products to add value.

## The benefits of adding value

The added value of a product goes towards paying off a company's fixed costs. The higher the added value, the sooner costs can be paid off and the quicker a business will make a profit. The more value a business can add to its products, the more chance the business has of success, survival and long-term growth.

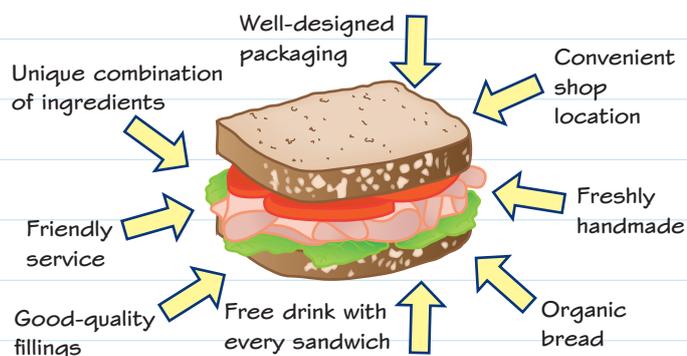
## Unique selling point

A **unique selling point (USP)** is another way to add value to a product. A USP will also help a business compete.

Developing a USP can be aided through understanding customer needs and market mapping.

## Mix and match

Most products combine a range of features to add value and improve competitiveness. The most successful products are the ones that are able to keep costs down as they add new features or benefits.



Option C will add value through raising after-sales service, and Option D will add value through a stronger brand image. Customers are willing to pay more for these things.

## Worked example

Target grade 1

Which **two** of the following are strategies that a professional gardener might use to help their business achieve high levels of added value? Select **two** answers:

(2 marks)

- A Ensure a profit is made on every job completed
- B Give price discounts
- C Visit every customer 48 hours after work is completed to take feedback
- D Develop a strong brand awareness in the local area
- E Compare the prices of competitors every month

## Now try this

Target grade 1

Which **one** of the following is most likely to be a reason why a business would try to add value to its products? Select **one** answer:

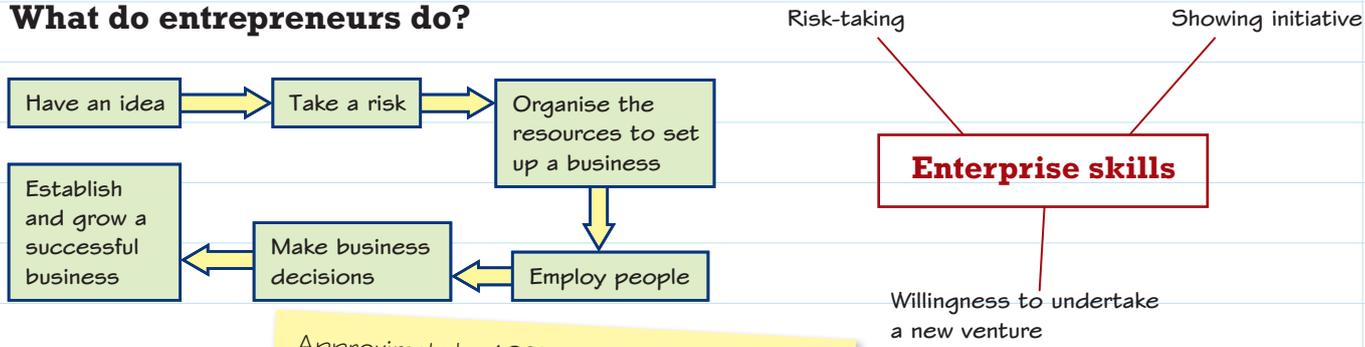
(1 mark)

- A To increase the materials it buys
- B To add a USP
- C To differentiate its product
- D To improve its chances of survival in the long term

# The role of entrepreneurship

An **entrepreneur** is a person who owns and runs their own business. Entrepreneurs are **risk-takers** who have an **initial idea** and the willingness and confidence to see it through.

## What do entrepreneurs do?



Approximately 40% of businesses fail within their first four years of trading.

## Entrepreneurs innovate

Entrepreneurs create new products through **invention** and **innovation**.



## Benefits to the economy

Entrepreneurs benefit the economy by:

- creating products and services to meet people's needs
- creating jobs
- generating economic activity through consumer spending
- paying tax to the government
- exporting goods abroad.

## Worked example

Target grade 1

Which **two** of the following are key features of enterprise?  
 Select **two** answers: (2 marks)

- A Employing at least one worker
- B Having the right qualifications to run a business
- C Being prepared to take risks
- D Having a willingness to take on a new venture
- E Registering as a private limited company

When answering questions about enterprise, remember that it involves the things required to start a new business.

## Now try this

Target grade 1

Which **two** of the following are key enterprise skills? Select **two** answers: (2 marks)

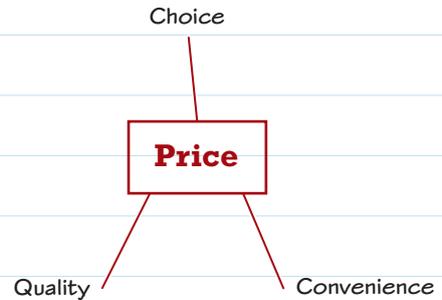
- A A willingness to take risks
- B A willingness to employ at least five workers
- C A willingness to take the initiative
- D A willingness to follow a course of study in business
- E The ability to raise finance

# Customer needs 1

If a business is to make products and services that are **desirable** and **profitable**, they must be able to **meet customer needs** successfully. A business that can meet customer needs will encourage **repeat purchase** and **attract new customers**.

## What customers want

When making decisions about products and services, customers will make a decision based on the balance of the four factors shown in the diagram. All of the factors are **linked through price**, because a business's ability to provide a product at the right price will depend on the level at which it meets the other factors. For example, improving the standard of product quality by using better-quality raw materials may increase costs, which will have an effect on the price.



## Meeting customer needs

Customer need	Example
Price	Charging a price that is 20% lower than competitors' prices
Choice	A restaurant serving a menu that offers more than 30 different dishes
Convenience	A business offering customers next-day delivery on all items
Quality	A clothes manufacturer using only the highest grade of cotton in all garments

## Worked example

Target grade **4**

Explain **one** reason why a business might sell a wide range of products. **(3 marks)**

A business would sell a wide range of products to give customers more choice. If customers have more choice, it is more likely that they will find a product that meets their needs. As a result, the business will increase its sales because all customers will find something that they like.

In this answer, the student starts by identifying a reason linked to customer needs. The student then goes on to explain why providing customers with a choice would be beneficial. They have developed the reason with two linked strands of development. You do not need to give context in an 'explain' question.

## Now try this

Target grade **1**

State **one** way that a business could meet customer needs through providing high-quality products. **(2 marks)**

Had a look Nearly there Nailed it! Investigating  
small businessSpotting a business  
opportunity

# Customer needs 2

A business cannot treat all of its customers the same way. Customers with similar needs will be influenced in different ways by their **personal circumstances** and **characteristics**. A business must understand the differing needs of its customers so that it can continue to generate sales and survive.

## Personal circumstances

### Family needs

Customers with children will have different needs from a couple with no children

### Financial needs

People with different incomes will choose to buy products and services at different **price points**

## Understanding customers

### Personal tastes and preferences

All customers have personal preferences based on style, colour, function and personal taste

### Emotional needs

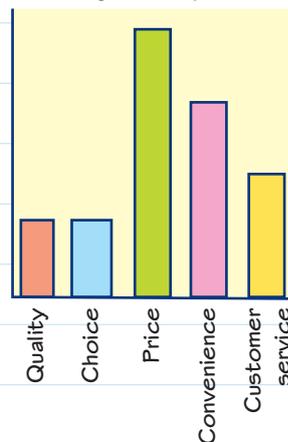
Some customers may have strong emotional connections to certain brands and products

## Customer needs and different products

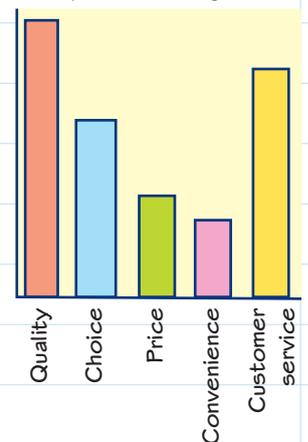
A customer's needs will differ for different types of products. In some cases, the right price may be more important than choice. In other circumstances, it may be the other way around.

For example, a customer buying a short-haul flight to Europe may value price and **convenience** over quality or customer service. However, the same customer buying a different product, such as a pair of hiking boots, may be willing to pay a high price if they receive excellent customer service (advice from a specialist) and a high-quality pair of boots.

A - Customer preference for a flight to Spain



B - Customer preference for a pair of hiking boots



## Worked example

Target grade 2

Which **two** of the following are likely to be the most effective methods that an office furniture business might use to meet customer needs?

Select **two** answers: (2 marks)

- A Securing repeat purchases by customers
- B Fulfilling customer orders quickly
- C Setting non-financial objectives
- D Selling furniture at a competitive price
- E Advertising on local radio

## Now try this

Target grade 2

Which **one** of the following is a reason why customer service is important to the success of a small business? Select **one** answer: (1 mark)

- A Customers are the ones who add value
- B A small business wants to get repeat purchases
- C Customers will buy a product if the price is right
- D It has to meet legal requirements

Only Options B and D have anything to do with meeting customer needs. Option B is an example of convenience and providing good customer service. Option D is an example of meeting customer needs through appropriate pricing.

# The role of market research

A business will carry out **market research** appropriate to its size and the nature of its market. The purpose of market research is to help a business to understand its **customers**, **competitors** and the **market** in which it operates, in order to make informed decisions about its products and services.



## Worked example

Target grade 2

Lisa Gallagher believes there is a growing market for gardening services. She has conducted some market research to test her idea and has summarised her findings.

Type of household	Percentage
Single – no children	7
Single – with children	11
Single – pensioner	28
Couple – no children	9
Couple – with children	31
Couple – pensioners	14

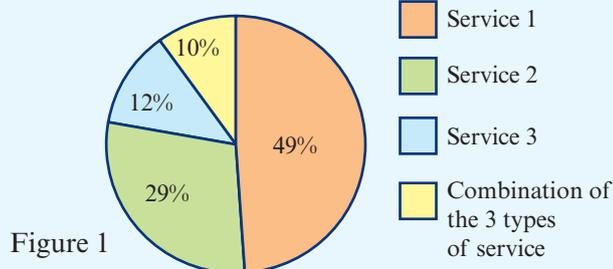


Table 1

Study Table 1 and Figure 1. According to this information, which **two** conclusions can Lisa draw from the data?

Select **two** answers:

(3 marks)

- A 100% more single pensioners than pensioner couples are interested in Lisa's business
- B Lisa should not offer Services 2 or 3 as there is no demand
- C Her main two segments are couples with no children and singles with children
- D More than half of people prefer something other than Service 1
- E Couples with children are more likely to use Service 1

**Quantitative skills**

Make notes on what the data tells you. It is important that you interpret the data correctly before you begin to choose the correct answers. Once you are sure that you understand the data, eliminate the options that you know are incorrect. Why are Options B, C and E incorrect?

## Now try this

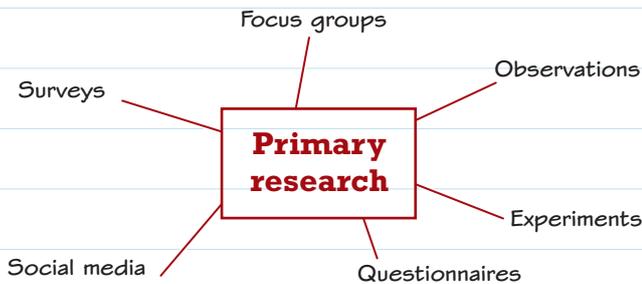
Target grade 6

Discuss why a business may conduct extensive market research before it begins trading.

(6 marks)

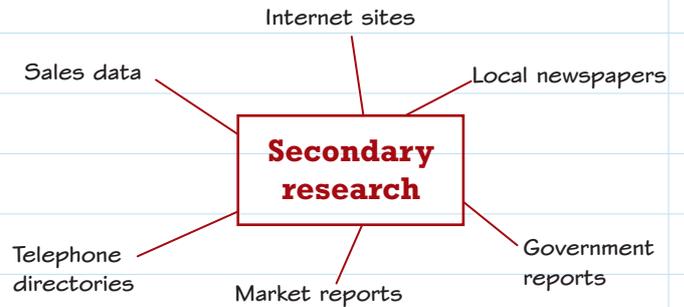
# Types of market research

**Primary research** (field research) is collecting information that did not exist before. This first-hand contact with customers is valuable to a business in understanding its market.



- More accurate
- Up to date
- Specific to needs
- Effective at collecting qualitative data
- Direct customer contact

**Secondary research** (desk research) is the process of gathering secondary data, which is information that already exists.



- More general
- Less time-consuming
- Effective at collecting quantitative data

Many businesses use **social media** as a cheap way to collect information on market trends, customer opinions and the actions of their competitors.

## Market research questions

Focus on...	Example questions
Customers	<ul style="list-style-type: none"> <li>• What do our customers value?</li> <li>• What benefits are offered by our product?</li> <li>• How can we improve our products?</li> <li>• How much are our customers willing to pay?</li> </ul>
Competitors	<ul style="list-style-type: none"> <li>• Who are our closest rivals?</li> <li>• What is their <b>market share</b>?</li> <li>• What makes them competitive?</li> </ul>
Market	<ul style="list-style-type: none"> <li>• What is the price of existing products or services?</li> <li>• How many people are buying these products?</li> <li>• Is the market growing or shrinking?</li> <li>• What are the latest trends?</li> </ul>

## Worked example

Target grade 3

Which **two** of the following are the benefits of conducting secondary market research instead of primary market research? (2 marks)

Select **two** answers:

- A It adds value to the products
- B It is less time-consuming
- C It offers a wider range of information
- D It is more specific to the target market
- E It will lower the costs of production

Ways of collecting market research data include:

- multiple-choice questions
- yes/no questions
- sliding scales such as 1–10
- customer comments.

Target grade 2

## Now try this

Which **one** of the following would not be an appropriate method of market research for a new small business? Select **one** answer:

(1 mark)

- A Employing a specialist market research company to carry out a survey of 10 000 people
- B Using published statistics about market trends
- C Asking customers to fill in a short questionnaire on the premises
- D Conducting an interview

# Market research data

There are two categories of market research data:

- **qualitative data** – information about people’s opinions, judgements and attitudes
- **quantitative data** – data that can be expressed as numbers and statistically analysed.

## Size and scale

Market research can be **expensive** and small businesses may only do a little. Larger businesses may pay a market research company to carry out extensive primary research. The greater the **sample size** (proportion of the population) used, the more **accurate** the research will be.

**Effective market research** is likely to link quantitative and qualitative information together. For example, it would help a business understand a 20% fall in customer satisfaction ratings if a focus group revealed that this was due to the layout of the business’s new website.

## Bias

Bias is the inclination to agree with an idea. Market research data can be **biased** if customers give the answers that they think the business wants them to give, for example when a small business owner collects the opinions of family. Bias also occurs by not surveying a **representative** sample of people. For example, a cafe owner will receive different feedback on his menu from people eating lunch to those just wanting a drink, so only asking those people will result in biased data.

## Reliability

In order to make good business decisions, research data should be **reliable** – it should come from a representative sample and the questions should enable people to give accurate and relevant answers.

This leads the customer to agree with the statement so the data would be biased.

People with 0 or 3+ pets cannot answer, so the data would be inaccurate.

✗	✓
Don't you agree that this product should only be available in black? Yes/No	Tick your colour preference for this product. <input type="checkbox"/> red <input type="checkbox"/> green <input type="checkbox"/> black
How many pets do you have? <input type="checkbox"/> 1 <input type="checkbox"/> 2 <input type="checkbox"/> 3	How many pets do you have? <input type="checkbox"/> 0 <input type="checkbox"/> 1-2 <input type="checkbox"/> 3+

## Worked example

Target grade 5

Apple produces home electronics, including the iPad and iPhone, for the mass market. Product design is an important part of its success.

(a) Give **one** method of collecting qualitative market research. **(1 mark)**

Focus groups

(b) Analyse the impact on Apple of using qualitative market research to improve its understanding of customer needs. **(9 marks)**

Qualitative research will give Apple information about whether consumers think their computers, iPads and iPhones are good-quality products. This will enable Apple to change their product design so that consumers will pay more.

Other methods include interviews, consumer panels or questionnaires/surveys.

This is a good start to a 9-mark 'analyse' question. The student should now develop their answer. This may include at least two different reasons applied to the context of Apple.

## Now try this

Target grade 1

1 Define the term 'market research'. **(1 mark)**

Target grade 4

2 Give **one** way in which a business might collect quantitative market research data. **(1 mark)**

3 Explain **one** way in which market research data might benefit a business. **(3 marks)**

Had a look Nearly there Nailed it! Investigating  
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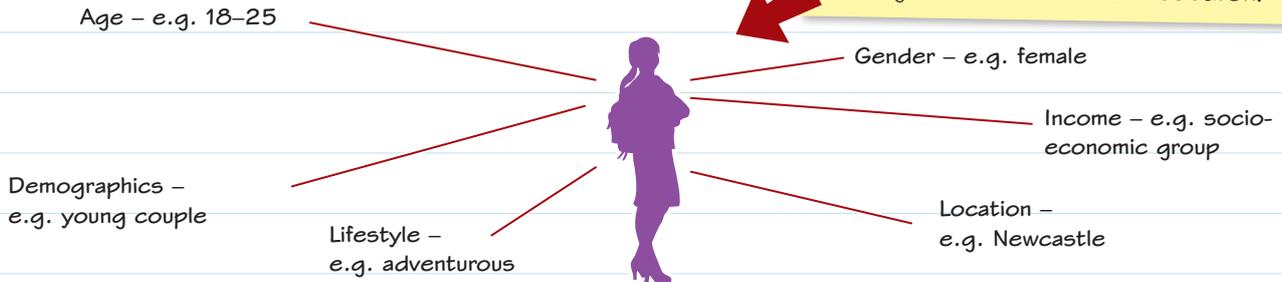
# Market segmentation

A **market segment** is a group of buyers with similar characteristics and buying habits. Segmenting a market allows a business to understand its customer needs and to target its customers better.

## How to segment a market

A market can be segmented in many ways, based on the characteristics and needs of customers.

In order to accurately segment its market, a business must have a good understanding of its customer needs through effective market research.



## Benefits of segmentation

Market segmentation allows a business to:

- 👍 meet specific customer needs
- 👍 **differentiate** its products
- 👍 focus on a specific group of customers
- 👍 target its marketing activity
- 👍 develop a unique brand image
- 👍 build close customer relationships.

## Limitations of segmentation

- 👎 Targeting a range of different customers with different products and services can be costly.
- 👎 Focusing on one group of customers can cause a business to miss another opportunity.
- 👎 Customer characteristics change over time, such as lifestyle, income and demographics.

Businesses have to continually update their understanding of their customers as customer needs change over time.

## Worked example

Target  
grade **4**

Explain **one** way in which effective marketing can help improve the products of a business. (3 marks)

If a business understands its customers' needs, its products and services can be developed to meet these needs. This means that the products will be more attractive and desirable, leading to a greater number of sales.

Make sure that you:

- identify **one** way (for example, product development)
- make two further expansion points about the way that you have identified.

## Now try this

Target  
grade  
**2-4**

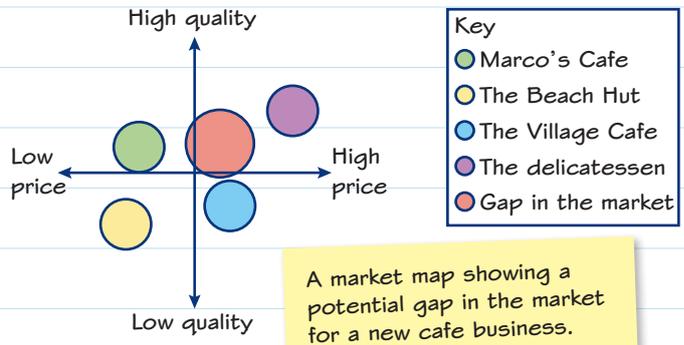
- 1 Define the term 'market segment'. (1 mark)
- 2 Explain **one** reason why a business may choose to segment its market. (3 marks)

# Market mapping

Market mapping helps businesses to position their products by identifying gaps in the market.

## Market maps

A market map is a diagram that can be used to position and compare products in a market. It is also used to identify **gaps in the market**, which are opportunities where customer needs are not being met. A market map will compare businesses based on two **variables**, such as price and quality.



## Benefits of market mapping

- Helps to identify potential gaps in a market (opportunities).
- Helps businesses to identify their closest rivals.
- Supports market segmentation.
- Helps businesses to make decisions about marketing and positioning its brand.

## Limitations of market maps

- Based on opinions and perceptions, rather than on accurate data.
- Compares businesses based on only two variables, which is simplistic.
- Can be difficult to identify the most appropriate variables.

## Head-to-head competition

There doesn't always have to be a gap in the market for a business to be successful. Businesses can target the same customers as other businesses and still succeed:

- if there is enough demand in the market (enough customers)
- if the business is able to meet customer needs better than its competitors (by offering more choice or better customer service).

## Worked example



According to the market map, which **one** of the following describes a gap in the market? (1 mark)

- Select **one** answer:
- A High price / traditional
  - B High price / fashion
  - C Low price / traditional
  - D Low price / fashion

Target grade 2

Option D is the only quadrant where there are no other businesses.

## Now try this

Target grade 4

Which **two** of the following are **most likely** to be important in spotting a new business opportunity in the cycling market? Select **two** answers:

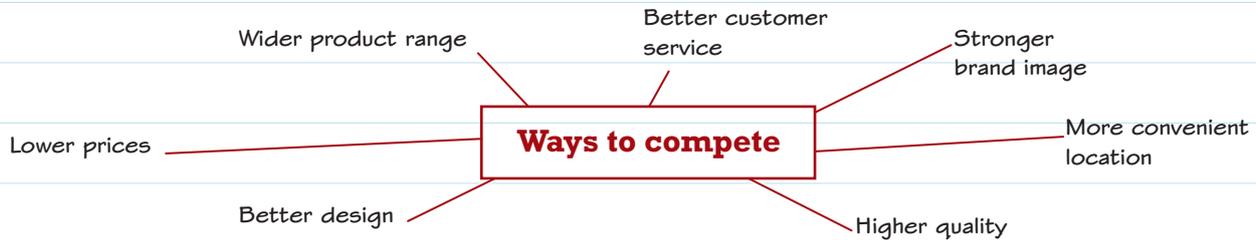
(2 marks)

- A Being able to produce a product cheaply
- B Recognising a new gap in the market
- C Being a keen cyclist
- D Identifying the possible competitors
- E Having a large amount of personal savings

Had a look Nearly there Nailed it! Investigating  
small businessSpotting a business  
opportunity

# Competition

A business might use a number of criteria to analyse the **strengths** and **weaknesses** of its **competition** in order to adjust its business offering and **differentiate** its products and services.



## Differentiation

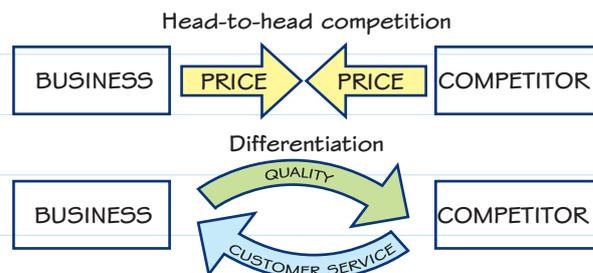
**Product differentiation** is about making a product different from others in some way. It helps businesses:

- to position their products and target different market segments
- to gain an advantage over rivals when faced with competition.

It allows consumers to see clearly that their needs are being met more effectively by one product than by another.

## How to differentiate products

Instead of competing head-to-head, businesses can try to differentiate their products.



## Worked example

Target grade 2

Which **two** of the following methods are mostly likely to differentiate a driving school from its rivals?

Select **two** answers:

- (2 marks)
- A Providing high-quality tuition
- B Operating as a sole trader
- C Providing a personalised service
- D Operating in a competitive market
- E Providing a service for the community

Options A and C are ways in which a business can differentiate what it does.

## Now try this

Target grade 2

Which **two** are the most likely methods that a small independent music store might use to compete with a large supermarket chain that also sells CDs?

Select **two** answers:

- (2 marks)
- A Lower its prices below that of the supermarket
- B Launch an advertising campaign on national television
- C Provide an ordering service for hard-to-find CDs for their customers
- D Open up two new stores in the town
- E Focus on improving the quality of customer service

# Competitive markets

## What is a competitive market?

A market is **competitive** when there are a large number of businesses relative to the number of potential customers. Competition is also high in markets where businesses sell very similar products and services that are difficult to differentiate.

The market for sugar is highly competitive because there is little difference between one producer's sugar and another's. This means that businesses mainly compete on price, although quality may also be considered. On the other hand, cakes and confectionary products can be highly differentiated, allowing businesses to compete in different ways.



## Competition and business decision-making

Some of the decisions that a business might make in a highly competitive market include:

- improving efficiency
- finding ways to improve competitiveness (see page 13 to revise competition)
- differentiating its products and services
- lowering its prices
- giving customers special offers
- cutting costs.

## Drawbacks of highly competitive markets

A business that operates in a highly competitive market might have to:

- lower prices in order to compete
- accept lower **profit margins**
- cut back on expenditure
- be careful about how and when it expands
- monitor its competitors closely.

Consumers benefit from competition as it encourages businesses to lower their prices and also to improve quality and customer service.

## Worked example

Target grade 4

Explain **one** reason why a business might decide to lower the price of its products. (3 marks)

A business might decide to lower its prices in order to remain competitive against other businesses. If a business lowers its prices, it will seem more appealing to customers compared to other alternatives. As a result, customers may choose it over rivals and its sales **revenue** may increase.

The student has explained how price is one way that a business might compete against rival businesses. An 'explain' question does **not** require you to analyse the benefits and drawbacks (e.g. the fact that the business might also lower its profit margins by reducing its prices).

## Now try this

Target grade 1-4

- 1 State **one** possible method a business could use to differentiate its product. (1 mark)
- 2 Explain **one** reason why a differentiated product might benefit a business. (3 marks)

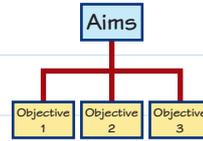
# Aims and objectives

All businesses set **objectives**. Sometimes these are financial objectives, which can be expressed in money terms. Businesses also have non-financial objectives. These are more personal and may involve helping others.

## The objectives hierarchy

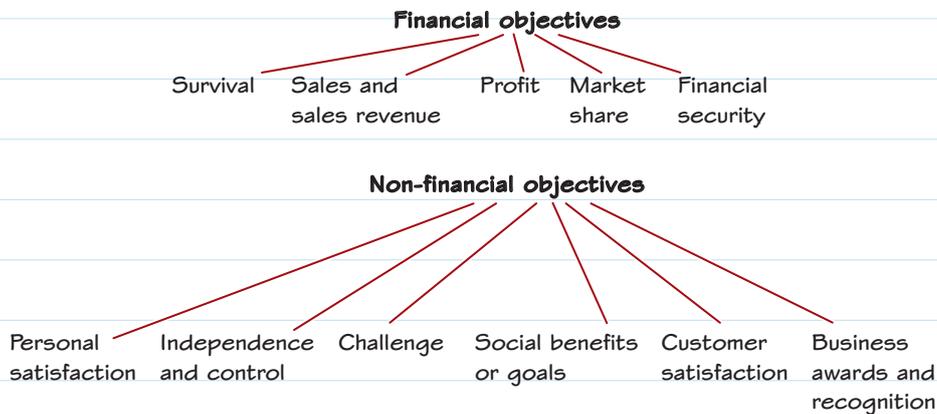
**Aims** are the general goals that a business sets. An aim can be the purpose for a business's existence.

**Objectives** are more specific than aims, but they contribute to a business achieving its aims. Objectives can be either financial or non-financial.



Most businesses will have an overarching aim that is supported by a number of SMART objectives, often specific to functions of the business.

## Typical objectives for a start-up



## Worked example

Target grade 2

Which **two** of the following are the most likely reasons why an individual would want to start a business?

Select **two** answers:

(2 marks)

- A To use the profits of a business to make a difference
- B To work fewer hours each week
- C To avoid paying income tax
- D To show their boss that they are as good as them
- E To control their own future

Both Option A and Option E are examples of non-financial objectives. Option A involves helping others, while Option E is about independence and control (being your own boss). Options B–D are not really viable objectives for starting a business.

## Now try this

Target grade 2

Which **one** of the following is the most likely reason why Sonia decided to set up a business?

Select **one** answer:

(1 mark)

- A She wanted to have more spare time
- B She wanted to have more independence when making business decisions
- C She wanted to make a guaranteed profit
- D She wanted to reduce the number of risks she had to take

# Differing aims and objectives

As a business develops and grows, so do the ambitions of the entrepreneur or owner who runs it. This means that different businesses have different aims and objectives. It also means that the aims and objectives of a business change, depending on its current stage of development.

## Business A



Business A has been running for six months. It has started to gather a loyal **customer base** and to receive **repeat purchases**. Initial customer reviews are positive.

Business A's objectives are to:

- survive
- have independence and control
- achieve 100% customer satisfaction
- achieve financial security.

These objectives are appropriate for Business A because many small businesses fail within the first few years of opening. The owner wants the independence of running their own business. Customer satisfaction is very important if the business is to grow.

## Business B



Business B is a chain of 15 stores nationwide. It has been established for 12 years and in the last five years has become the second largest of its type in the market. It is a **public limited company (PLC)**. Turn to page 50 for more on PLCs

Business B's objectives are to:

- become market leader
- achieve a sales revenue of £200 million
- donate 1% of all profits to charity.

These objectives are appropriate for Business B because a large successful business may have a realistic ambition to become market leader. Its success over the last 12 years and its **shareholders** will mean that the business will have profit targets. As a large business, it may also wish to give something back to society by donating to charity.

## Worked example

Explain **one** reason why a business would set financial objectives. (3 marks)

A business would set a financial objective because most businesses are judged on their financial success. If the objective is to increase revenue as a percentage of sales (units) then this would be a quantifiable objective and easy to measure. Increasing revenue increases the likelihood of the business making a profit.

Target  
grade 4

The student has explained why financial performance is important to a business and how a financial objective linked to revenue would help achieve this.

## Now try this

Target  
grade  
1-3

- 1 Give **one** example of a non-financial objective. (1 mark)
- 2 Define the term 'market share'. (1 mark)

# Revenues and costs

A business must understand the difference between the price it charges to customers and the cost of producing its products. If it knows how many products it sells, it can calculate its total revenue and its total costs. It can then calculate profit.



Quantitative skills

## Calculating revenue

**Revenue, sales revenue or turnover** is the amount of income received from selling goods or services over a period of time. It can be calculated using the formula:

**LEARN IT!**

$$\text{Revenue} = \text{Price} \times \text{Quantity}$$



## Fixed and variable costs

**Fixed costs** do not vary with the output produced by a business, e.g. business rates.

**Variable costs** change directly with the number of products made, e.g. raw materials.

**LEARN IT!**

$$\text{Variable costs} = \text{Cost of one unit} \times \text{Quantity produced}$$



Quantitative skills

## Total costs

**Total costs** are all the costs of a business.

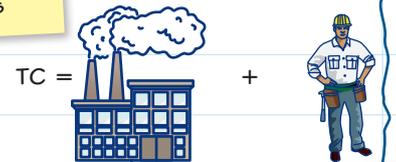
It can be calculated using the formula:

**LEARN IT!**

$$\text{Total costs (TC)} = \text{Total fixed costs (TFC)} + \text{Total variable costs (TVC)}$$

$$£900 = £400 + £500 = £400 + (£5 \times 100)$$

Fixed costs, e.g. business rates



Variable costs, e.g. wages

## Worked example

Target grade 2

Hancock's is a small pottery business that specialises in garden plant pots. It has the following financial information for one month.

Number of pots produced and sold: 150

Average price per pot: £10

Fixed costs per month: £500

Variable costs per pot: £2

Which **one** of the following represents the total costs for Hancock's during the month?

Select **one** answer:

A £450

C £800

B £650

D £1500

(1 mark)



Quantitative skills

Be careful.

You could arrive at an incorrect answer to this question if you use the numbers incorrectly in your calculation.

## Now try this

Target grade 6

The following table shows the costs, revenues and profits of a cleaning company for a two-month period. Complete the table with the **four** missing figures.

(4 marks)

	October	November
Revenue	£14 000	£12 000
Fixed costs	£2 000	£2 000
Variable costs	(i)	(iii)
Total costs	£9 000	(iv)
Profit	(ii)	£5 000

# Profit and loss

A business must be able to calculate whether it is making a profit or loss. It must also understand how making a profit or loss can have an impact on the business and its owners.



Quantitative skills

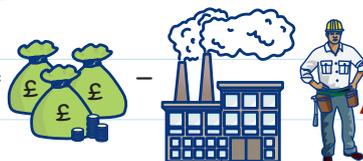
## Profit and loss

**Profit** occurs when revenues of a business are greater than its total costs. If a business's costs are greater than its revenues then it will make a loss. Profit or loss can be calculated using the formula:

**LEARN IT!**

$$\text{Profit} = \text{Sales revenue} - \text{Cost of sales}$$

Profit or loss =



$$£1000 - £900 = £100 \text{ profit}$$

There are two different kinds of profit: gross profit and net profit. You can revise these on page 73.

## Profit as an objective

Profit is the objective of many businesses because it allows a business to:

- survive
- reinvest profits for expansion
- provide security and savings
- reward employees
- generate wealth for the owner.

Profit can also act as an incentive to start the business.



Quantitative skills

## Calculating interest on loans

In your exam, you may be required to calculate the total **interest** to be paid on a loan.

**LEARN IT!**

$$\text{Interest (on loans) \%} = \frac{\text{Total repayment} - \text{Borrowed amount}}{\text{Borrowed amount}} \times 100$$

## Interest rates

Interest is the % reward for saving



Interest is the % cost of borrowing

## Worked example

Target grade 4

Which **two** of the following actions is most likely to increase a pottery business's profit, assuming that it sells the same number of pots each month?

Select **two** answers:

(3 marks)

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> A Buy cheaper raw materials to make its products | <input type="checkbox"/> C Buy more expensive raw materials to make its pots |
| <input type="checkbox"/> B Increase the number of workers employed over the weekend  | <input type="checkbox"/> D Increase advertising expenditure                  |
|  | <input checked="" type="checkbox"/> E Relocate to cheaper premises           |



Quantitative skills

Options B, C and D would actually increase the business's costs. Options A and E would lower costs.

## Now try this

Target grade 6

A business spent:

- £10 000 on raw materials
- £30 000 on fixed costs
- £7500 on other variable costs and had a turnover of £50 000.

The business now buys its raw materials 10% more cheaply from a new supplier. What effect will this have on profit?

Select **one** answer:

(1 mark)

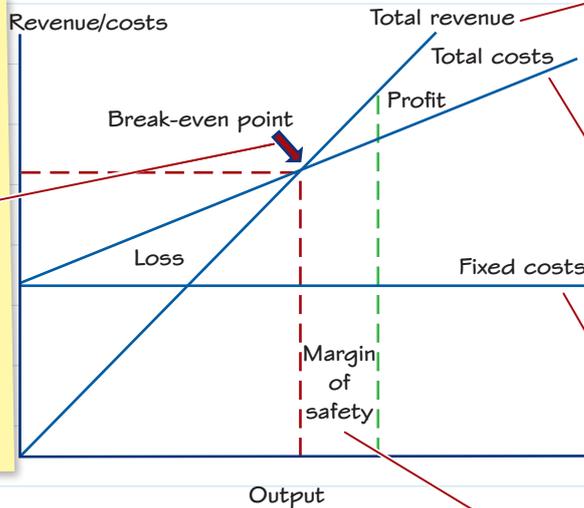
The profit level will:

- |  |   |
|--|---|
| <input type="checkbox"/> A Increase by £2500 | <input type="checkbox"/> C Increase from £2500 to £3500 |
| <input type="checkbox"/> B Fall by £2500     | <input type="checkbox"/> D Increase by 10%              |

# Break-even charts

**Break-even** is the level of output at which a business's revenue covers its total costs. At this point the business is making neither a loss nor a profit. Break-even is an important financial concept as it allows a business to make important decisions about prices, sales volumes and costs.

The point on the graph where total costs and revenue meet is the **break-even point** or **break-even level of output**. When **total revenue** exceeds the break-even point, the business makes a **profit**. When total revenue falls below the break-even point, the business makes a **loss**.



**Total revenue** is the amount of money earned by a business from selling products. It increases directly with the number of products sold.

**Total costs** are the sum of all the costs at any level of output.

The **fixed costs** line is horizontal because fixed costs do not change at any level of output.

The **margin of safety** is the amount of output between the actual level of output where profit is being made and the break-even level of output. This is how much production could fall before the business starts to make a loss.



Quantitative skills

Formulae to know

**LEARN IT!**

**Revenue** = Price × Quantity

**Total costs (TC)** = TFC (total fixed costs) + TVC (total variable costs)

**Break-even point in units** =  $\frac{\text{Fixed cost}}{\text{Sales price} - \text{Variable cost}}$

**Break-even point in revenue / costs** = Break-even point in units × Sales price

## Worked example

Target grade 5

Using the information below, calculate Sony's break-even point when its PlayStation 4 console was priced at £300. You are advised to show your workings.

Fixed costs: £2400000

Variable costs: £140 per console

Break-even = Total fixed costs ÷ (Price - Variable cost per item).

Break-even = £2400000 ÷ (£300 - £140)

Break-even = 15000 consoles

(2 marks)



Quantitative skills

Make sure you:

- show accurate workings
- calculate the correct answer.

## Now try this

Target grade 5

Using the information below, calculate the level of profit or loss Sony would make if it sold 20000 PlayStation 4 consoles at £300 each. You are advised to show your workings.

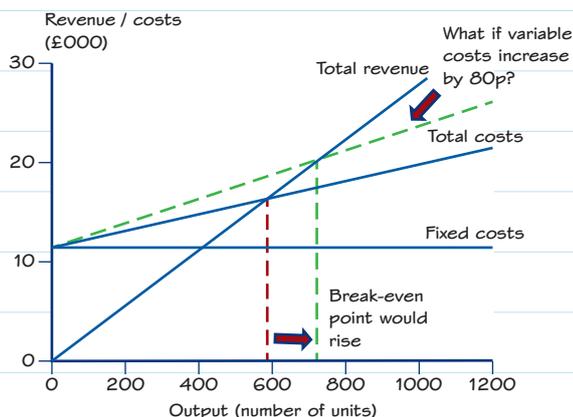
Fixed costs: £2400000      Variable costs: £140 per console

(2 marks)

# Using break-even

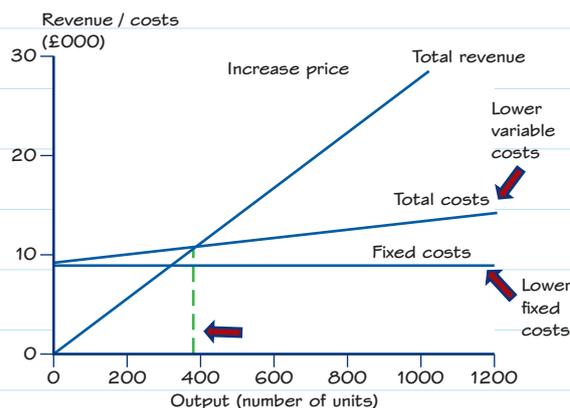
Break-even analysis is a useful tool to help a business make decisions, set targets and plan for the future.

Break-even analysis is a useful tool for answering 'What if?' questions such as: what would be the impact of an increase in variable costs on profit? A fall in fixed or variable costs or an increase in price is likely to lower the break-even point.



## Lowering the break-even point

Break-even analysis can identify strategies for lowering the break-even point and increasing profit.



A business can only lower the break-even point successfully so long as productivity, quality and demand are not compromised. For example, although increasing price will lower the break-even point, some customers may be put off and choose a product from a competitor.



Quantitative skills

### Interpreting break-even charts

**The break-even point:** where the total revenue and total costs lines intersect, read the number of units required to break even from the x-axis (e.g. 1000 units).

**The margin of safety:** subtract the break-even point (in units) from the actual or predicted level of output/sales (e.g. 700 units).

**LEARN IT!**

$$\text{Margin of safety} = \text{Actual or budgeted sales} - \text{Break-even sales}$$

**Caution!** The concept of break-even assumes that a business will sell all the products it makes. In reality, if a business increases price it will lower the break-even point, but might deter customers from buying.

## Worked example

Target grade 5

Discuss the reasons why a business might use a break-even chart. (6 marks)

When launching a new product, a business could use a break-even chart to identify the number of units it must sell in order to cover its costs. Using this information, a business can then make decisions on how many units it will need to produce and carry out market research in order to understand whether it believes there is sufficient demand to sell this number as a minimum...

## Now try this

A business is using a break-even chart to examine the effect of a reduction in the price of its product.

Target grade 1

1 State **one** problem a business may face as a result of reducing the price. (1 mark)

Target grade 3

2 Explain **one** limitation for a business of using a break-even chart. (3 marks)

This student has identified a reason and developed their explanation. They could now go on to develop a second reason with further development.