Enterprise

Basics of Business

BUSINESS ENTERPRISE	The process of identifying new business opportunities and taking advantage of them.
PRODUCT	A good or service provided by a business.
GOOD	A physical item, e.g. a book.
SERVICE	An action performed by other people to aid the customer, e.g. hairdressing.

Enterprise can involve starting a new business or expanding an existing one.

Purposes of Business Activity

Business activity needs a purpose, e.g.:

1. To provide a good or service.
2. To meet customer needs.

Customer needs change over time, so businesses need to change their products to keep up.

3. To add value to an existing product, e.g. by:
   - making a product more convenient for customers
   - building a good brand image
   - improving the product's design or quality
   - giving the product a USP (unique selling point) — a feature that makes it different from its competitors.

Reasons for New Business Ideas

1. Changes in technology

E.g. creating apps for new smartphones or tablets.

2. Changes in what customers want

E.g. people wanting products that are more environmentally friendly.

3. Products becoming obsolete (no longer used)

Firms may need new products to replace obsolete ones, e.g. typewriters became obsolete when personal computers became available.

New business ideas could either be original, or adaptations of existing products or ideas.

Entrepreneurs

Three Qualities of Entrepreneurs

ENTREPRENEUR — someone who takes on the risks of enterprise activity.

An entrepreneur must be able to:

1. Organise resources — e.g. making sure the business has the right resources at the right time.
2. Take risks — e.g. investing money to start a business when success isn't guaranteed.
3. Make business decisions — e.g. deciding the business's aims, its structure, who to employ, how to grow and what to do if things go wrong.

Three Risks for Entrepreneurs

1. Financial loss

If the business doesn't make a profit, they may lose money they invested and might struggle to pay back money they borrowed.

2. Little job security

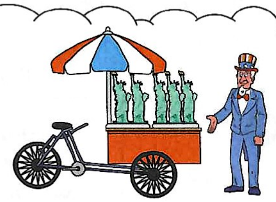
They might have quit their job to start the business. If the business fails, they could lose money and become unemployed.

3. Failure

If the business fails, they might have wasted the time, money and effort they put in (that they could have used for other things).

Three Rewards for Entrepreneurs

1. Success — many entrepreneurs get great satisfaction from seeing their ideas be successful.
2. Profit — they may make more money than in their previous job if the business makes lots of profit.
3. Independence — they can choose what they do each day, and what direction the business goes in.


"It's the independence I like the most..."

Competition and Customer Needs

Competition

COMPETITOR — a business that sells the same products in the same market as another business.

Businesses need to understand customers to be able to meet customer needs — so they can increase sales and ensure the business survives.

Businesses compete with others to fill customer needs — they must persuade customers to buy from them instead of their competitors.

Five Ways to Compete

Businesses look at the strengths and weaknesses of competitors in different areas to help them decide how to stand out:

	Customer Need	How Firm Can Compete
1 Pricing	Customers generally want to pay less for products.	Reduce prices to compete with similar products (but firm will make less profit per product).
2 Customer Service	Customers want good customer service. More likely to use firm and spend more for good service.	Train staff to give good service, or provide extra services to stand out against competition.
3 Quality	Customers want good quality products.	Improve and emphasise quality of products (though this can increase costs).
4 Product Range	Customers like to have a wider range to choose from, to find a product that best suits them.	Develop new products to fill gaps in product range — there's less competition for new products and the firm appears innovative.
5 Location	Customers prefer not having to travel far or wait a long time when buying products.	Open new stores or sell online to be more convenient.

Market Research

Five Ways Market Research Helps Firms

1. Find out general information about the market, e.g.:
   - **MARKET SHARE** — the proportion of total sales in the market controlled by a business.
   - **MARKET SIZE** — how many potential buyers or sellers of products there are, OR the total value of products in a market.

2. **Understand customers**
   Helps a firm...
   - know who customers are
   - know customers' needs
   - know how to satisfy customers' needs.

3. **Make informed decisions**
   Helps firms decide e.g. price of products.

4. **Reduce risks**
   Helps firms avoid selling the wrong products (i.e. something unwanted).

5. **Spot a gap in the market** (when a customer need is not being met)
   Firms may fill a gap by, e.g.:
   - selling in a new place
   - marketing products in a new way.

Primary Market Research

PRIMARY RESEARCH — market research that involves getting information from customers or potential customers.

E.g.: observations, surveys, questionnaires, focus groups.

Businesses can use social media (e.g. Twitter, Facebook) to collect information on e.g. what's increasing in popularity.

\+
- up-to-date information
- relevant and specific to a product
- can be targeted at specific markets

−
- needs large samples to be reliable
- often expensive
- time-consuming

Secondary Market Research

SECONDARY RESEARCH — market research that involves looking at data collected by other people.

E.g.: market reports, government reports, articles from newspapers or the internet.

\+
- cheaper than primary research
- easily found
- instantly available

−
- often out of date
- not always relevant
- not specific to firm's product

Types of Data

QUANTITATIVE DATA — information that can be measured or reduced to a number.

QUALITATIVE DATA — information that involves people's feelings or opinions.

Reliable market research data (where results can be repeated) is important as it represents customers most accurately.

Market Segmentation and Mapping

Market Segmentation

SEGMENTATION — when people within a market are divided into different groups.

Segmenting a market can help a business aim its marketing strategy at its...

TARGET MARKET — the specific group of people that a product is aimed at.

Three Ways to Segment a Market

1. **By DEMOGRAPHIC** — an identifiable characteristic of people within a population.
   For example:
   - **Age** — customers of different ages have different needs.
   - **Income** — how much people earn affects what they will buy.
2. **By location** — people who live in different areas want different products.
3. **By lifestyle** — a customer's hobbies and interests affect what they will buy.

Mapping a Market

Helps a business understand its position in the market and the market's key features.

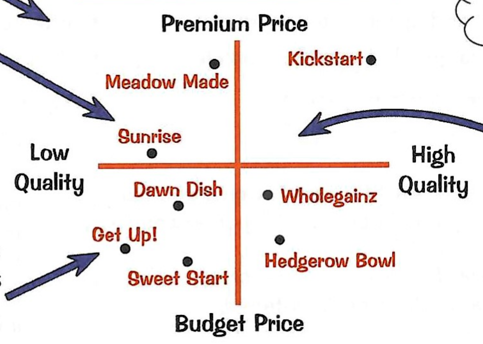
Can make it easy to spot:
- competitors
- gaps in the market.

Market maps show two variables, one on each axis. This map has a price axis and a quality axis.

Businesses or products are plotted on the map according to how customers view each one.

There are a lot of products that are lower quality and have a budget price. This is the most competitive part of the market.

Market Map for Cereal Brands



There is a gap in the market for a higher quality product with a lower premium price.

Use market mapping to find potential gap in market. → Do market research to see if demand exists. → If there is demand, develop new product to fill the gap and stand out from competitors.

Aims & Objectives for New Businesses

Aims and Objectives

AIM — an overall goal that a business wants to achieve.

OBJECTIVE — a measurable step that a business uses to work towards an aim.

Five Financial Aims

1. **Survival** — having enough money to stay open, e.g. to pay staff and buy stock to sell.
2. **Maximise profit** — this is an aim for almost all firms.
3. **Financial security** — reach a point where the business can be funded by its own revenue.
4. **Maximise sales** — increasing sales helps grow market share.
5. **Increase market share** — take sales from competitors or bring in new customers.

Four Non-Financial Aims

1. **Challenge** — some people get a sense of accomplishment from starting a business.
2. **Personal satisfaction** — for some, starting a business means they get to do a job that they are passionate about.
3. **Independence and control** — being their own boss means the owner gets control over what they do each day.
4. **Social objectives** — an owner can choose to run their business in ways they believe are morally right.

Factors Affecting Aims and Objectives

Size and age

Small or new firms often focus on survival.

Bigger firms might focus on financial security and market share.

Competition

Firms with lots of competition often focus on survival or sales.

Firms with little competition can focus on profits and market share.

The owner

Small firms may prioritise personal satisfaction over e.g. market share.

Private limited companies have shareholders, so may focus on maximising sales and profit.

Revenue, Cost, Profit and Interest

Revenue

REVENUE — income businesses make by selling products.

revenue = quantity sold × price

EXAMPLE

The stationery company Jot It Down sells 10 000 notebooks for £5 each. What is their sales revenue?

revenue = 10 000 × £5 = £50 000

Costs

FIXED COSTS — costs that don't change with output, e.g. rent, insurance, advertising.

Fixed costs are only fixed in the short term — they increase as the business grows.

Fixed costs are paid even if the business produces nothing.

VARIABLE COSTS — costs that increase as output increases, e.g. factory labour, raw materials, running machinery.

total variable cost = quantity sold × variable cost per unit

The total cost is the sum of the fixed costs and variable costs.

total cost = total fixed cost + total variable cost

Profit

PROFIT — the difference between revenue and costs over a period of time.

profit = revenue – costs

If costs are higher than revenue, the business makes a loss — the amount of profit is negative.

EXAMPLE

In May, Jot It Down has a revenue of £10 000, and has total costs of £4000. How much profit does Jot It Down make in May?

profit = £10 000 – £4000
= £6000

Interest

INTEREST — the cost of borrowing money (or the reward for saving).

$$\text{interest} = \frac{\text{total repayment} - \text{borrowed amount}}{\text{borrowed amount}} \times 100$$

This gives the interest as a percentage of the amount borrowed.

EXAMPLE

Jot It Down borrowed £5000. They paid back £5500 in total. What was the interest on the loan?

$$\text{interest} = \frac{5500 - 5000}{5000} \times 100$$
$$= \frac{500}{5000} \times 100 = 10\%$$

Break-Even Analysis

Break-Even Points

BREAK-EVEN POINT — the level of sales or output a business needs to cover its costs.

Selling more than break-even point = profit.
Selling less than break-even point = loss.

A low break-even point means a business doesn't have to sell as much to make a profit.

Calculating Break-Even Points

The break-even point can be measured by the number of units a business needs to sell:

$$\text{break-even point in units} = \frac{\text{fixed cost}}{\text{sales price} - \text{variable cost}}$$

This is per unit.

Or by revenue needed:

break-even point for revenue = break-even point in units × sales price

'Revenue' could be replaced with 'costs'.

EXAMPLE

Kelly's Keyrings has fixed costs of £8000. The variable cost per keyring is £3 and each keyring sells for £7.
What is the break-even point in units?

Break-even point in units
$$= \frac{8000}{7 - 3} = \frac{8000}{4}$$
= 2000 units

What is the break-even point for revenue?

Break-even point for revenue
= 2000 × £7
= £14 000

Margin of Safety

MARGIN OF SAFETY — the gap between current output and break-even output.

margin of safety = actual sales (or budgeted sales) – break-even sales

Budgeted sales (the sales a business expects to make) are used to forecast a future margin of safety.

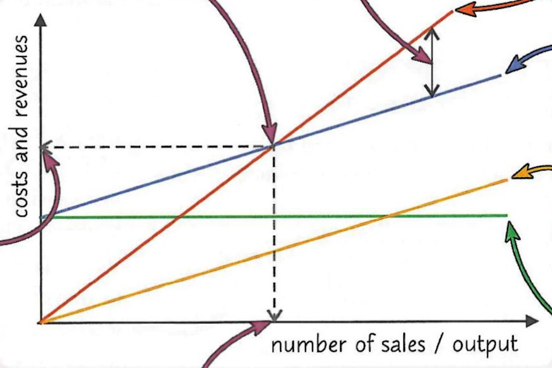
EXAMPLE

Speak-eze need to sell 500 speakers to break even.
Next year, they expect to sell 800 speakers.
What will their margin of safety be next year?

margin of safety = 800 – 500 = 300 speakers

Break-Even Diagrams

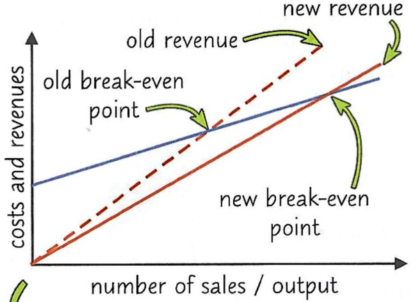
Features of Break-Even Diagrams



Changing Revenues and Costs

Break-even diagrams can be used to see how changes in revenue or costs affect the break-even output.

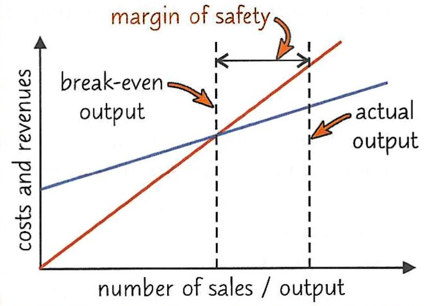
E.g. after lowering prices:



Revenue rises at a slower rate, so more units have to be sold to break even.

Margin of Safety

You can show the margin of safety on a break-even diagram.



Cash and Cash Flow

Cash

CASH — money a business has available to spend immediately. Businesses need cash to pay employees, suppliers and overheads (ongoing expenses, e.g. rent and lighting).

Not having enough cash could lead to insolvency (being unable to repay debts).

A business can make a profit but still run out of cash, e.g. if they reinvest all the money they make.

Cash Flow

CASH FLOW — the flow of money into and out of a business.

net cash flow = cash inflows – cash outflows (for a given period of time)

e.g. from selling products

e.g. for wages or buying materials

Positive cash flow = more cash inflow than cash outflow.

+ no problems making payments

– losing opportunities to invest

Positive cash flow isn't the same as profit. Profitable businesses can have poor cash flow if cash inflow doesn't happen in time to meet the required outflow.

Cash Flow Forecasts

CASH FLOW FORECAST — shows the cash expected to flow into and out of the business over time. Used to show when a business won't have enough cash.

Cash Flow Forecast — Sweetie Chocs			
	Dec	Jan	Feb
Total receipts (cash inflow)	7000	800	5500
Total payments (cash outflow)	4500	4500	4000
Net cash flow (inflow – outflow)	2500	(3700)	1500
Opening balance (bank balance at start of month)	1000	3500	(200)
Closing balance (bank balance at end of month)	3500	(200)	1300

Opening balance = closing balance of previous month

Closing balance = opening balance + net cash flow

Net cash flow is negative in January — outflow is greater than inflow.

Numbers in brackets are negative.

They will need extra finance in January — knowing this in advance means they can plan ahead.

Sources of Finance — Small Businesses

Five Reasons New or Small Businesses Need Finance

1. Start-up capital to set up the business.
2. To cover poor initial cash flow.
3. To cover a shortfall in cash, e.g. because of delayed payments from customers.
4. To cover day-to-day running costs of struggling businesses.
5. To expand the business, e.g. to pay for new premises or equipment.

Short-Term Sources of Finance

Trade credit — paying suppliers one or two months after the purchase.

+ time to earn money to repay debt

− late repayment = large fees

Overdrafts — taking more money out of a bank account than is actually in it.

+ can make payments on time without having the cash

− high interest rate, bank can cancel overdraft, bank can repossess assets if not paid back

If only Kyle had repaid his overdraft, he would still have his favourite hat.

Long-Term Sources of Finance

Loans — borrowing money, e.g. from a bank.

+ quick and easy, lower interest rate than overdrafts

− making monthly payments increases fixed costs, bank can repossess assets if not paid back

Personal savings — owner can invest their own money.

+ easy, no interest payments

− owner could lose their money if business fails

Retained profit — the owners invest profits back into the business.

Share capital — individuals buy shares and get part ownership in the business. The business can use the money they raised from issuing shares.

Venture capital — money raised through selling shares to individuals or businesses who specialise in funding new or expanding firms. May expect returns sooner than other shareholders.

Crowd funding — lots of people contribute a small amount of money, sometimes for a reward. Often used for creative or innovative businesses and takes place online.

Business Ownership Structures

Unlimited vs Limited Liability

UNLIMITED LIABILITY — business owners are liable for paying back all debts if the business fails (even if they have to sell everything they own).

LIMITED LIABILITY — company is liable for paying back debts, not the owners. They only risk losing the money they have invested.

Sole Traders

Most small businesses, e.g. plumbers, hairdressers

SOLE TRADER — a business with just one owner. (They can have other employees.)

+ Advantages

- easy to set up
- full control over business and profit

− Disadvantages

- responsibility can mean long hours and few holidays
- unlimited liability
- hard to raise money
  Banks see sole traders as risky.
- unincorporated

The business has no legal identity — suing the business means suing the owner.

Partnerships

E.g. solicitors, doctors' surgeries

PARTNERSHIP — a business owned by a group of partners. Partners usually have an equal say in the business and equal shares of the profits.

+ Advantages

more owners = more...
- ideas
- skills
- capital (money)
- people to share work

− Disadvantages

- unlimited liability (usually)
- each partner is legally responsible for all the others
- partners have to share profits
- partners might disagree on business decisions

This means the business has a separate legal identity from its owners.

Private Limited Companies

PRIVATE LIMITED COMPANY — a business that is incorporated and owned by shareholders. Shares can only be sold when all shareholders agree.

Private limited companies have 'Ltd.' after their name.

+ Advantages

- limited liability
- easier to get loans

− Disadvantages

- expensive to set up
- required to publish accounts every year

Franchises and Business Location

Franchising

FRANCHISE — an agreement where one business pays to sell another business's products or use its ideas/trademarks.

FRANCHISOR — the established business that allows another firm to sell its products or use its ideas/trademarks.

FRANCHISEE — the new business buying into the franchise.

Franchisees can trade under their own name (e.g. car dealerships) or use the name of the franchisor (e.g. fast-food restaurants).

+ Advantages

- brand recognition can help sales
- can be easier to get loans (seen as less risky)
- franchisor might help franchisee with e.g. training, management

− Disadvantages

- less freedom — limited by franchisor's rules
- extra costs from payments to franchisor

Four Factors Affecting Business Location

LOCATION

1 Competition

Being near competitors means skilled labour and suppliers are easier to find.

Competition can mean losing sales or having to reduce prices.

2 Labour supply

Areas with high unemployment have good labour supply and lower wages.

Towns and cities might have colleges that can provide training.

3 Raw materials

Lower transport costs if raw materials are nearby.

4 Market location

Cheaper to transport finished product if customers are nearby.

Businesses that rely on passing trade must be easy to get to.

Priorities depend on the nature of the business. E.g. if raw materials are hard to transport but the product isn't, it's best to be near raw materials.

Effects of the Internet

Business location is more flexible due to the internet:

E-commerce means businesses can locate further from their market and closer to raw materials.

Some businesses don't need fixed premises for shops (due to e-commerce) or offices (due to working from home).

The Marketing Mix

Four Elements to Marketing

These four Ps make up the **marketing mix**.

1 Product

The product must fulfil customers' needs or wants.

2 Price

Customer must think the product is good value for money.

3 Promotion

Potential customers need to know the product exists and want to buy it.

4 Place

Customers need to be able to buy the product — e.g. in a shop, online or straight from the producer.

The different elements of the marketing mix affect each other. E.g. people will pay more if they think the product is high quality.

Technology and Marketing

E-commerce provides a new **place** for businesses to sell products.

Digital communication provides new ways to **promote** products, e.g. by email or on social media.

Firms need to adapt their marketing mix to reflect customers' changing needs. E.g. products with older technology may no longer meet the needs of customers, so have to be sold at a lower price to compete.

Competition and Marketing

Businesses might change their marketing mix to respond to competition by e.g.:

- lowering **prices** to make their products more attractive than competitors' products.
- developing new **products** to match a competitor's range or offer something unique.
- spending more on **promoting** their products so they seem more appealing.

Business Plans

Uses of Business Plans

BUSINESS PLAN — an outline of what a business will do and how it will do it.
Can be used to plan new businesses or to make changes to existing businesses.

Four ways business plans can be useful:

1. Forces owner to think carefully about the business's needs, and work out the cost of the idea.
2. Can prove to financial backers that the idea is worth investing in.
3. Provides an opportunity to identify and reduce risks — or to realise the business is actually a bad idea.
4. Helps people make decisions, e.g. what objectives should be set to achieve aims, how much stock to buy.

Features of Business Plans

Business idea — what the business is all about. Could include unique selling points of the product.

Business aims — usually very general, e.g. becoming the market leader in a certain area.

Business objectives — more specific than business aims, e.g. a target number of sales in a certain period.

Forecasts — the projected cash flow, and estimates for revenue, profit and costs.

Finance — how much money is required and who will provide it.

Marketing mix — how the business will use the four Ps to sell products.

Target market — who the business will sell to, using market research to show the target market is interested.

Location — where the business will locate, and why.

Stakeholders

Influence of Stakeholders

STAKEHOLDER — anyone who's affected by a business.

Businesses are also affected by stakeholders, as their opinions must be considered when making business decisions.

Different stakeholders can have **conflicting opinions**, so businesses need to decide who to listen to in each situation.

When selling hiking gear, it's important to keep your stickholders happy.

Seven Examples of Stakeholders

Shareholders get paid dividends when the firm makes profit.

Stakeholders	Like objectives based on...	Reason
1 Owners / shareholders	Profitability and growth	They get more money.
2 Managers and other employees	Profitability and growth	Better job security and career prospects.
	Ethics	Better wages and working conditions.
3 Suppliers	Profitability and growth	They get more custom.
4 Local community	Profitability and growth	May provide new jobs and mean people have more money to spend in local shops.
	Ethics and the environment	Local environment isn't harmed, e.g. by noise or pollution.
5 Government	Profitability, growth and job creation	More money from taxes.
6 Customers	Customer satisfaction	High quality products and low prices.
7 Pressure groups	Often ethics and the environment	They have strong views on certain subjects.

Pressure groups are organisations that try to influence what people think about a certain subject, e.g. animal welfare. They can create bad publicity if they don't agree with a business's actions.

Technology and Business

E-Commerce

E-COMMERCE — buying and selling products using the internet.

+ **Convenient** for consumers as they can buy from all over the world whenever suits them.

+ Good for firms as they can reach **wider markets**.

Firms need to adapt to the growing need to use e-commerce by e.g.:

- building websites,
- employing IT specialists,
- developing ways to distribute to online customers.

Six Methods of Digital Communication

1. **Websites** — Useful for a wide range of stakeholders. E.g. can provide product information for customers and publish reports for shareholders.

2. **Apps** — Used to communicate mainly with customers, e.g. about products and promotions.

3. **Social media** — Good way to communicate with a large group of people at once. Often used for customer service and promotion, e.g. to advertise products or events.

4. **Email** — Quick and easy way to communicate either with individuals or a larger group of people.

5. **Video calls** — Convenient way to have meetings with stakeholders based in different locations, e.g. employees on different sites.

6. **Live chats** — Instant messages often used for customer service and communication between employees.

More Technology and Business

Three Examples of Payment Systems

1. **Online payments** — can be done by:
   - Entering credit or debit card details on an app or website.
   - Using an online payment system such as PayPal.

These systems mean you don't have to enter card details on every website you buy from, so there's less chance of having card details stolen.

2. **Chip and PIN** — customer puts their payment card into a terminal at the checkout and enters their unique PIN to pay.

3. **Contactless** — customer holds their payment card or smart device near the terminal to pay.

+ Having fast and safe ways to pay can encourage customers to buy, and means that more customers can be served in a given time.

Three Impacts of New Technology on Business

1. **Marketing mix** — e.g. e-commerce means it's easier for firms to sell products to a wider area, which could affect how a firm prices and promotes products.

2. **Costs** — high costs initially but lower costs in the long term. E.g. it costs a lot to invest in new technology and train staff, but this can help people work more efficiently so fewer people are needed to carry out tasks.

3. **Sales** — sales increase, e.g. because apps and websites can make it easier for customers to find and purchase products.

Technology affects the products available to customers and how they are made and sold. Firms need to adapt to changes in technology so they stay competitive.

Employment Law

Law and Recruitment

EMPLOYMENT LAW — different laws associated with employer-employee relationships.

All employees must have a legal right to work in the UK — this can mean extra work for a firm (e.g. checking documents).

Pay

There's a minimum amount that firms need to pay their workers:

- **National Minimum Wage (NMW)** — for workers aged 22 and under, but of school leaving age.
- **National Living Wage (NLW)** — for workers aged 23 and over. Slightly more than the NMW.

These amounts are usually increased every year.

Effects of pay laws on businesses:

+ Potentially better motivated staff and higher productivity.

− Can increase costs, which could mean:

higher prices → reduced sales → reduced income → fewer employees

Health and Safety

Health and safety laws mean firms need to:

- carry out risk assessments to identify possible workplace dangers,
- take reasonable steps to reduce risks,
- provide staff with health and safety training and suitable safety equipment.

Effects of health and safety laws on businesses:

+ Reduces staff health problems and injuries (so less chance they'll need time off work).

− Higher costs (e.g. paying for training courses).

Discrimination

Equality Act 2010 — employers can't discriminate against anyone because of e.g.:

race, religion, sexual orientation, disabilities, age, gender

This affects recruitment and pay — all employees must be paid the same for doing the same job, or work of equal value.

Firms have a responsibility to make sure employees don't discriminate against others either — they may need to write policies and train staff about equal rights.

Breaking Employment Laws

Potential impacts:

- Compensation costs
- Fines
- Bad publicity
- Closure of the firm

Consumer Law

Consumer Rights Act 2015

The Consumer Rights Act 2015 covers how products can be sold — it aims to protect the consumer.

Three criteria a product needs to meet:

1. **Be fit for purpose** — it has to do the job it was designed for.

2. **Match its description:**
   - It needs to match its trade description (the way the business describes it in terms of e.g. its size, quantity, materials, properties).
   - It's illegal to say that a product has been endorsed by a person or organisation unless it really has been.

3. **Be of satisfactory quality** — it should be well made and shouldn't cause problems for the buyer (e.g. a fridge shouldn't be excessively noisy).

Three Impacts of Breaking Consumer Law

1. Customers can ask for their **money back**, a **repair** or a **replacement** — this costs the business money.
2. Customers could take the business to **court**, which can be very costly.
3. The business could get a **bad reputation**, which could reduce sales.

Following Consumer Law

Firms need to:

- **Train staff properly**, so they don't mis-sell products and know what to do if a customer isn't happy.
- Keep up to date with **changes in the law**, and make changes to their business if needed, e.g. by retraining staff.

This is true for all laws that affect a business, not just consumer law.

Unemployment and Government Taxes

Downsides of Unemployment for Businesses

Lots of people unemployed. → People have less **disposable income** (money left after they've paid tax). → Demand for products falls. → Sales fall. → Firms respond, e.g. by reducing prices, reducing output, making staff redundant.

Different economic conditions, e.g. unemployment or inflation, change the economic climate. This can have a big effect on firms, but they can't control it.

Firms may need to spend money retraining new workers who had been unemployed.

Potential Benefits of Unemployment for Businesses

1. Less money spent on **wages** — lots of people wanting a job means people may be prepared to work for less money.
2. Easier to **recruit** — there are lots of people available to work.
3. **Government grants** — the government may give grants to firms who provide new jobs in areas of high unemployment.

These factors may encourage a business to grow when unemployment is high.

Government Taxes

Tax rates are set by the government.
Both consumers and businesses pay tax, e.g.:

Consumers pay income tax (tax on money they earn).

Businesses pay tax on their profits, tax on premises they own, and environmental tax on activities that harm the environment.

Changing tax rates can affect a business, e.g.:

income tax rates reduced → consumers have more disposable income → sales increase

If income tax rates increase, the opposite could happen.

business tax rates increased → business has less money left to reinvest → business growth is slower

A business may try to avoid this by e.g. finding ways to pay less tax, cutting costs elsewhere, or relocating to a country with lower tax rates.

If UK business tax rates are reduced, businesses have more money to reinvest. However, more firms from abroad might relocate to the UK, increasing competition.

Inflation and Consumer Income

Inflation

INFLATION — the increase in price of goods and services over time.

The rate of inflation is calculated by tracking the prices of regular household products over time.

Possible effects of high inflation on businesses:

- **Short-term increase in sales** — customers quickly buy products before prices go up even more.
- **Increase in labour costs** — workers want higher pay so they can afford to pay the higher prices for things.
- **Sales from exports fall** — products made in the UK become more expensive, so people in other countries are less likely to want to buy them.

High inflation generally means **low business growth** — it's hard to predict what will happen to costs and sales, so businesses are reluctant to take risks and invest in their business.

An increased rate of inflation was having no effect for Ahmed.

Consumer Income

Consumer income (the amount that consumers earn) increases over time.

If consumer income rises at a **slower rate** than inflation...

When this happens, income is said to be going down in 'real terms'.

→ Greater proportion of people's income spent on essential items, e.g. food.

→ Less money available for luxuries, e.g. holidays, so demand for these decreases.

Businesses that sell things at discount prices might benefit as people try to spend less.

Businesses could reduce prices or advertise more to increase demand, but this means they'd make less profit.

→ Businesses selling luxuries see fall in sales and profits.

The **opposite** is true when consumer income rises at a **faster rate** than inflation (i.e. demand for luxuries increases).

Interest Rates

Interest Rate Basics

% **INTEREST RATE** — a percentage that shows the cost of borrowing money or the reward given for saving money.

Lots of methods of borrowing money have interest rates, e.g. bank loans, mortgages, overdrafts and credit cards.

The higher the interest rate, the more interest you pay on money you've borrowed, and the more interest you earn from savings.

In the UK, most interest rates are linked to the base rate of interest. The Bank of England sets the base rate depending on the economic climate.

Effects of Interest Rate Changes

%↓ Lower interest rates → Increased spending

%↑ Higher interest rates → Decreased spending

If interest rate is cut...

↓

Cheaper to borrow money. Less money made on savings.

Amount needing to be paid back on existing borrowed money may also fall.

↙ Consumers borrow more and save less, so they have more money available to spend.

↓ Demand for products goes up.

↓ Sales and profits increase.

↘ Businesses borrow more, so have more money available to invest in the business.

↓ Increased investment leads to growth.

The opposite is true when interest rates increase — demand for products goes down, and businesses have less money. This may lead to slower growth and cost-cutting.

Exchange Rates

Exchange Rate Basics

EXCHANGE RATE — the price at which one currency can be traded for another.

Exchange rates fluctuate — they are affected by the economy of the country that uses the currency, and by the global economy.

When importing products, a firm pays in the currency of the country the product was made in. E.g. a British firm importing goods from the US will pay in US dollars.

A Fall in the Value of the Pound

£↓ = good for exporters.

Value of the pound falls. → UK products sold abroad get cheaper. → Increased sales and profits for firms that export a lot.

↓

Foreign products sold in the UK get more expensive. → Costs increase for UK firms importing raw materials. → May need to increase prices to cover costs. → Sales and profits may fall.

↓

Sales may increase for UK firms that compete with foreign imports.

Fall in £ value = 'weaker' pound.
Rise in £ value = 'stronger' pound.

A Rise in the Value of the Pound

£↑ = good for importers.

Value of the pound rises. → UK products sold abroad get more expensive. → Decreased sales and profits for firms that export a lot.

Firms that export a lot may move abroad so they can trade in local currency, meaning they're less affected by exchange rates.

↓

Foreign products sold in the UK get cheaper. → Costs decrease for UK firms importing raw materials. → Profits may rise.

↓

Sales may decrease for UK firms that compete with foreign imports.