



About the exam

The **Unit 1 exam** is divided into two sections.

Section A is worth 20 marks in total and is typically testing your *knowledge* and *calculation skills*. The exam normally commences with 3 x 2 mark questions that require you to *explain* and define some key terms from the specification.

EXAM TIP

On a 2-mark question, aim for 3 marks! Try to give a precise and accurate definition, and use an example to show further understanding of the key term.

You will then be expected to work out a couple of number-crunching questions – normally worth about 6 marks in total.

EXAM TIP

The trick here is to look for the relevant data in the case study that can be used to answer the question set. Questions will expect you to apply formulae and are normally a lot simpler than you may think. After answering a question, take a moment to consider whether your answer is realistic.

The final question on Section A will typically be 'Explain two factors...' – worth about 8 marks. It is important that you develop *two* relevant points – link them back to the case study and ensure you both *apply* and *analyse* your answers.

Section B is worth 40 marks in total and will consist of three longer-style questions. The first question is typically worth 10 marks and will expect you to *analyse* your answer as well as *applying* it to the business. *No judgement* is required if the question has 'analyse' as the trigger word.

The final two questions (worth 15 marks each) will be *evaluative* and it is *vital* that you make a *judgement*, as each one will carry 5 marks for a *justified judgement*.

EXAM TIP

A good approach is to use the three-paragraph rule. The question will normally start with the trigger words 'To what extent...' or 'Evaluate...' Give a paragraph explaining the advantages and follow up by giving a paragraph explaining the disadvantages. You should then conclude with a decisive paragraph that states what you think is the most important issue and back this up.

Exam skills

Success in any exam is about playing to the rules set out by the examiners. The four key skills that they will be looking for are as follows:

Knowledge and understanding: Have you learnt and understood the key terms?

Application: Have you thought about the business and used the data?

Analysis: Have you managed to build up a good chain of reasoning/argument?

Evaluation: Have you made a judgement and backed it up?

The mark schemes are now based around the following categorisation in relation to the four skills above:

Is the answer... good? reasonable? limited?

You need to make sure that your answers are clearly applied to the business presented in the exam, that you develop a line of argument and that you then come to a conclusion.

EXAM TIP

Students across the land are scared to make a judgement – make sure that you are not! Give an opinion and back it up. It is far better to do this than simply sit on the fence.

Exam practice

In addition to tackling the integrated case studies provided on pages 17–21, you should gain exam practice by working through past papers. These are readily available on the AQA website (www.aqa.org.uk) along with the associated mark schemes. Try and tackle these under the same time constraints that you will have in the exam itself. You have 1 hour and 15 minutes to complete the exam, so practise! You want to give yourself every chance of success, and you will only do this if you know how to pace your responses and if you understand how marks are allocated.

Throughout this guide look out for the **A-Grade Analysis/Evaluation Examples** in order to see how to turn your responses into A-grade answers.

Starting a business

The main aim of this part of the specification is to look at the role of entrepreneurs and the range of activities involved in setting up a small business.

Enterprise

Entrepreneur

Definition: An **entrepreneur** is an individual that takes calculated risks when deciding on setting up a business venture in pursuit of an idea.

Role

- ▶ Combines other factors of production (land, labour, capital) to produce a product/service that adds value
- ▶ Sources finance
- ▶ Balances risks when making decisions
- ▶ Uses skills to produce a profitable business

Frequent characteristics

- ▶ Driven and keen to succeed
- ▶ Problem solver
- ▶ Calculated risk taker
- ▶ Innovator
- ▶ Able to adapt and learn from mistakes
- ▶ Passionate

The importance of risk and rewards

The entrepreneur takes a risk in setting up a new business and will be rewarded with the profits that come with success, or suffer the losses that arise from failure.

Opportunity cost

Definition: The opportunity cost is the 'real cost' of an action measured in terms of the next best alternative foregone.

There will be an opportunity cost to the entrepreneur in setting up a new business, such as the wages given up from previous employment. A tough decision between two good locations for a business will carry a high opportunity cost.

Motivation and objectives

Fundamental to the motivation of the entrepreneur are **profit** and **adding value** – two crucial concepts that we will return to later.

Running a successful and profitable business is the long-term vision. However, there are various objectives that businesses may follow and these can be remembered by using the acronym **PIGSS**.

Profit Making a profit from a venture and generating a return for the entrepreneur are essential for long-term success.

Image The reputation of the firm is vital.

Growth Growing the business and building up a wider customer base are likely to lead to future success and increased profits.

Service A high standard of service is important for customer retention and the firm's reputation.

Survival The rate of failure of any new business is high and so surviving the first year of operation is often the first aim of any new start-up.

Government support

Government may support businesses through:

- ▶ Increased funding to schools to raise awareness of business opportunities
- ▶ Helping and supporting new business start-ups via Business Link
- ▶ Offering lower taxes
- ▶ Providing government grants
- ▶ Targeting areas of high unemployment with regional development grants for business start-ups
- ▶ Assisting organisations such as the Princes Trust and Young Enterprise by allowing them to benefit from charitable status

▶▶▶ A-GRADE ANALYSIS EXAMPLE

By offering help to entrepreneurs, the government will benefit because the business will generate employment within that area, which will then lead to a positive multiplier effect as



the people employed will have more money to spend within the local community, helping to develop and support other businesses. If the firm is successful, it will generate profits that the government can then tax in order to provide greater funds to allocate to the public sector or to provide support for future entrepreneurs to generate further wealth.

➤➤➤ A-GRADE EVALUATION EXAMPLE

In my opinion it is vital that the government looks to support and help entrepreneurs set up new business ventures. This is because it is the privately run businesses that are able to make goods and provide services that can then generate profits. Such support creates employment and makes the UK more competitive on the global stage. Entrepreneurs should be able to take risks and develop their businesses with the assistance of government rather than being thwarted by excessive rules and regulations. I believe that it is crucial that we encourage entrepreneurs rather than discourage them, as they create wealth and opportunities for not just themselves but also other stakeholders such as suppliers and the local community.

Generating and protecting business ideas

Sources of ideas

- Identifying a need for a new product/service
- Exploiting a gap in the market
- Bringing in a successful business from another area – copycat
- Having a hunch and spotting a new market – thinking ahead
- Analysing the market and improving on what is already there

How to identify a new product or market niche

- Small budget market research (*Yellow Pages*)
- Personal experience – failing to find what you need
- Using market mapping to identify possible gaps
- Observation – look around you to see the extent of competition
- Using your own market knowledge or particular skills

Franchises

Definition: A franchise is established when a business (franchisor) gives the right to supply its product or service to another business (franchisee).

Types of franchise

- Business format franchise
- Distributorship and dealership
- Agency
- Licensing

Franchisee – benefits

- Lower risk as you trade under an established brand name
- Easier to raise money as a more recognised business
- Will receive brand advertising and promotion by franchisor
- Franchisor provides support, advice and training

Franchisee – disadvantages

- Costs may be higher than expected
- Lower rewards than if the business had started under its own name
- A royalty payment is paid by the franchisee to the franchisor to use the name of the business – this is paid each year
- Other franchisees may damage the brand
- Less independence for the owner in decision making

Franchisor – benefits

- Regular financial reward via royalty payments
- Franchisee provides capital and takes risk
- Easier to grow the brand
- Franchisor controls quality, marketing and all major decisions

Franchisor – disadvantages

- Reputation may be damaged by a franchisee
- Expensive to monitor
- Profit from franchisor's idea is shared

➤➤➤ EXAM TIP

This is an area that is frequently examined. Make sure you read the question carefully and respond exactly to what you are being asked. You will normally be asked to analyse the advantages/disadvantages to either the franchisor or the franchisee, but not both.

➤➤➤ A-GRADE ANALYSIS EXAMPLE

By operating as a franchise, the business benefits from trading under an established brand name. This gives the firm greater recognition from prospective customers. The advertising of the franchisor allows the franchisee to benefit from marketing that it could not possibly have been able to afford itself, which leads to greater potential growth for the business.

EXAM TIP

The examiner will want you to evaluate setting up as a franchisee as opposed to setting up your own business – see p. 19.

Copyright, patent and trademark

It is possible to protect business ideas by using copyright, patents and trademarks.

Definition: Copyright is the legal protection against copying for authors, composers and artists.

Benefit: The copyright holder is able to charge a royalty or licence fee.

Definition: A patent is an official document granting the holder the right to be the only user or producer of a newly invented product or process.

Benefits

- ▶ Holder can sell the product without close competition for up to 20 years
- ▶ Profits earned by having a patent can be reinvested in further research and development
- ▶ The patent can be sold, rented or licensed
- ▶ A small business with a patent may be purchased by a larger one, simply for the patent

Disadvantages

- ▶ Expensive and time consuming to secure patent
- ▶ Preventing other firms from using your patent may prove expensive in legal costs

Definition: A trademark is a sign, logo, symbol or word(s) displayed by a company that distinguishes its brands from its competitors.

Benefits

- ▶ Provides an instantly recognisable image
- ▶ Creates a unique selling point (USP) by differentiation
- ▶ Makes it easier to launch new products
- ▶ May be possible to sell a popular trademark

EXAM TIP

The examiner will look to test whether you know the difference between the types of protection and also how you can develop an argument explaining the benefits of having the protection.

A-GRADE ANALYSIS EXAMPLE

By securing a patent the business will be able to protect itself against competitors seeking to copy its idea. By having a USP

the business might be able to charge a higher price and earn higher profits. It will also be able to differentiate itself from other firms operating within the industry. This will potentially allow the firm to increase its customer base and future sales, which can then enable it to carry out further research and development.

Transforming resources into goods and services

This part of the specification looks at the essence of all business activity – taking a series of inputs and transforming them into outputs that can be sold for a profit. This concept is known as **added value**.

All physical goods go through a chain of production – the three different sectors of industry (primary, secondary and tertiary), e.g. a table from IKEA (Figure 1).

Primary

- Extracting raw materials
e.g. forestry for timber

**Secondary**

- Manufacturing materials into finished goods
e.g. table-making factory

**Tertiary**

- Selling the goods in a retail space
e.g. IKEA showroom



Figure 1 The chain of production (e.g. for a table from IKEA)

Businesses selling services also look to add value and charge a higher price for the finished outputs than it cost to purchase the initial inputs.

ShakeAway, the milkshake franchise, will buy the ingredients for a malteser milkshake, i.e. milk and maltesers, for a unit cost of around 80p. However, by providing the service the company can then look to charge £2.20 for the shake – the value is added by the person who makes the shake!

Similarly you can choose to purchase a PizzaExpress pizza from the supermarket for £4.00 and cook it yourself, or you can eat in the restaurant and pay £8.00. The value added from eating in the restaurant comes from not having to cook the pizza yourself as well as from enjoying the atmosphere created in the restaurant.



Developing business plans

Business plan

Definition: A **business plan** is a document that sets out the goals of a new or existing business and how they can be achieved, specifying the marketing, operational and financial implications.

Purpose

- ▶ To clarify the idea
- ▶ To gain finance
- ▶ To monitor progress over time

Contents

- ▶ Summary of the business – type of ownership, name
- ▶ Personal information (CV of the owners) – background
- ▶ Objectives of the business (SMART – see p.16)
- ▶ Market research findings
- ▶ Financial information (projected cash flow forecasts and profit and loss accounts)
- ▶ Breakeven projections
- ▶ Sources of potential finance
- ▶ Proposed budgets

Sources of information for a business plan

- ▶ Prospective investors – banks, potential partners
- ▶ Managers and owners
- ▶ Small business advisers
- ▶ Bank managers
- ▶ Accountants
- ▶ Government agencies

Advantages

- ▶ Sets objectives and gives clear guidance to the business owners
- ▶ Objectives can motivate both the owners and the staff
- ▶ Helps the business monitor progress and review where necessary
- ▶ Will encourage investment from banks and other investors

Disadvantages

- ▶ The forecasts may be very unreliable
- ▶ Start-up costs are difficult to predict
- ▶ Market conditions might change as a result of new competitors or an economic downturn

▶▶▶▶ A-GRADE ANALYSIS EXAMPLE

By setting out a business plan, the firm is able to assess all aspects of the potential business idea. This will allow it to have a clear direction and purpose, which leads to a greater

formalisation of ideas and expectations for the business. By concentrating on the plan, the firm will be able to identify its likely strengths and weaknesses. This will allow it to concentrate on the essential aspects of the business and will facilitate further investment. This extra investment will hopefully allow the business to grow more quickly and it should be able to use both cash flow and breakeven forecasts to monitor and review its performance.

▶▶▶▶ A-GRADE EVALUATION EXAMPLE

In my opinion it is vital that a business plan is not only put in place but also used to assess how the firm is performing. Having SMART objectives that in particular are measurable will allow the firm to review its performance against the forecasts and objectives laid out in the plan. The business plan should be a fluid document – it needs to be modified according to how the business evolves. It is vital that a plan is not just used to secure finance; it should be returned to each year so that the firm can look to build on previous success and adapt as the business grows. Having a direction is crucial, but the plan should be flexible enough to allow the business to move in step with market conditions. Firms that continue to plan are, in my view, likely to prove more successful and have a competitive advantage.

Conducting start-up market research

Definition: **Market research** is the collection, collation and analysis of data relating to the marketing and consumption of goods and services.

Purposes of market research

- ▶ *Descriptive* – what is going on in the market right now?
- ▶ *Explanatory* – why are certain products proving popular?
- ▶ *Predictive* – what are the future trends and how can the research predict these?
- ▶ *Exploratory* – what will be the best ways to promote the new product?

Most business start-ups will be short on finance initially but would be able to conduct some low-cost market research, e.g.

- ▶ Look in local business directories or walk around the location to identify competitors in the area
- ▶ Produce a market map – a visual grid plotting where existing competitors sit on scales based on two important product features (price and quality).

Types of market research

Definition: Primary research involves the collection of data first hand for a specific purpose.

Definition: Secondary research involves the use of data or information that has already been collected.

Definition: Quantitative research gives numerical data (i.e. facts and figures) gathered by asking 'closed' questions.

Definition: Qualitative research gives opinions and views gathered by asking 'open' questions (i.e. how a customer is likely to feel about an issue).

»»»» EXAM TIP

Good primary research should look to combine both quantitative and qualitative research. Closed questions on a survey will make analysis of data easier, but the open questions may well provide more useful information. Remember that the business in the exam is likely to be a new start-up, which means that information about the probable success of the idea and what customers actually want will be crucial. Market research is required in order to understand the needs of potential customers, identify possible competitors and assess whether there is a gap in the market for the product or service under consideration.

Primary research methods

- ▶ Surveys or questionnaires (postal, internet, phone)
- ▶ Observation
- ▶ Focus groups
- ▶ Experiments
- ▶ Test marketing

Secondary research methods

Definition: Internal sources are data that the business might already have gathered.

Examples include:

- ▶ Loyalty cards
- ▶ Sales reports
- ▶ Company accounts

Definition: External sources are data that a third party might already have gathered.

Examples include:

- ▶ Trade magazines, e.g. *The Grocer*
- ▶ Marketing reports from companies, e.g. Mintel
- ▶ Independent reviews, e.g. *Which?*
- ▶ Internet sources and reviews, e.g. gocompare.com, moneysavingexpert.com

»»»» EXAM TIP

This area is frequently examined. You will be expected to know the advantages and disadvantages of the market research carried out by the business and to make a judgement about how it could have improved its research. This will link into the type of sample that the business chose. It is worth noting that the advantages of secondary research tend to be the disadvantages of primary research, so they are fairly easy to learn!

Advantages of primary research

- ▶ Can ask the exact questions required that are specific to the business
- ▶ Information is up to date
- ▶ Information is exclusive to the business
- ▶ Information is gathered first hand, so data can be quantitative and qualitative

Disadvantages of primary research

- ▶ Time consuming
- ▶ Expensive to collect
- ▶ Might still be biased

Advantages of secondary research

- ▶ Easier
- ▶ Faster
- ▶ Cheaper

Disadvantages of secondary research

- ▶ May be out of date
- ▶ Unsuitable – not specific enough
- ▶ Might contain errors
- ▶ Will possibly be biased, depending on how the research was carried out and by whom

Sampling

Definition: Sampling is where firms select a group of people whose views or behaviour should be representative of the target market as a whole.

Large samples increase reliability but are more expensive.

Types of sample

- ▶ *Random*: select people at random from a list, i.e. electoral register
- ▶ *Stratified random*: choose a group of people with similar characteristics, e.g. age group, and then select people at random from within this group
- ▶ *Systematic sample*: choose one name at random and then pick every tenth name after the first



- ▶ *Quota sample*: choose a set number of people from each particular group, e.g. 20 people aged 16–19, 30 people aged 20–25, 50 people aged 25+, to answer your survey
- ▶ *Cluster sample*: choose a group of people according to their geographical area

Factors affecting the choice of sample

- ▶ *The target market* – the sample should be based on who you intend your customers to be
- ▶ *Finance* – might limit the number of people chosen
- ▶ *Time* – if data are needed quickly, then a random sample might be better
- ▶ *The product itself* – new products will require a greater level of feedback
- ▶ *The risk involved* – basing any decision on the results of samples can be risky as by their nature they are just samples, though the larger the sample the greater the level of reliability

➤➤➤ A-GRADE ANALYSIS EXAMPLE

The market research methods chosen should be beneficial to the business. By using a focus group, the firm will be able to observe first hand and receive detailed feedback about a new product. It will also be able to pick up both quantitative and qualitative data. This will enable the firm to gather data on how much it could charge for its product as well as receive ideas about how it could improve its offering. The research will allow the firm to make adjustments and then produce a product that is more suitable for its chosen market. While the organisation of a focus group is relatively expensive and time consuming, the firm will be able to benefit by having a greater awareness of what it should be offering its customers. This is likely to result in higher sales, and therefore the cost and time spent on the focus group will probably more than pay for itself after the product has been launched.

➤➤➤ A-GRADE EVALUATION EXAMPLE

In my view the firm did not carry out enough market research at the beginning. The sample it chose was too small and included friends and family that were likely to give a biased set of results, since they would not wish to upset the owner. By just targeting men, the business was not receiving any feedback from women, even though the secondary data suggested that its potential target market was likely to comprise 30% women. By failing to research into the views of women, the firm is likely to miss out on a higher level of sales. I feel that it should have looked at conducting personal interviews rather than a postal survey, since the response rate from the postal survey was very low and did not provide sufficient data to justify action.

Understanding markets

As stated above, a business conducts market research in order to achieve a greater understanding of its customers and the market in which it operates. A firm needs to understand its business in both the local and national markets and identify the likely factors that will influence the demand for its product(s) or service(s).

Types of markets

- ▶ Local
- ▶ National
- ▶ Physical
- ▶ Electronic

Factors affecting demand

The factors affecting demand can be remembered by using the acronym **Price TIPS**.

- ▶ The **price** of the good itself
- ▶ The **price** of substitute goods or competitors' prices
- ▶ **Taste/fashion**
- ▶ **Income** of customers
- ▶ **Population**
- ▶ **Seasonality**

The firm may also look to reduce the size of its target market. This is known as market segmentation.

Market segment

Definition: A **market segment** is a subgroup of consumers with similar characteristics.

Examples of market segmentation

- ▶ Age
- ▶ Gender
- ▶ Income
- ▶ Location or region
- ▶ Occupation, i.e. socio-economic group

Firms may wish to segment their markets because it will be easier to produce a specific product for a particular segment, rather than targeting the mass market.

Benefits of market segmentation

- ▶ Gain greater knowledge of potential customers' needs
- ▶ Can offer different types of products to different segments
- ▶ Allows for greater targeting and the designing of products to suit that segment
- ▶ Can advertise directly to that segment

Drawbacks of market segmentation

- Will limit the size of the market
- Segment might be too small and competitive

Market share, market size and market growth

Firms will also want to know key information about their relative position in the market in which they operate.

Definition: Market share is the proportion of the total sales of a product achieved by a firm.

Definition: Market size is the measurement by volume or value of the total sales of a product.

Definition: Market growth is the percentage change in sales by volume or value over a specific time period.

➤➤➤ EXAM TIP

Examiners will nearly always ask you to calculate one of these measures. You must know which measurement you are being asked to calculate and how to perform the calculation. You should also check your answer. Does it look right?

➤➤➤ NUMBER CRUNCHING

Cotswold Kebabs has a business in Cheltenham. Last year it recorded sales of £180,000. The takeaway market within Cheltenham had sales of £1.4 million. This market is forecast to grow by a further £200,000 this year. Calculate the following:

- Cotswold Kebabs' market share last year
- Market size for this year
- Market growth

Cotswold Kebabs' market share last year:

$$\frac{£180,000}{£1,400,000} \times 100 = 12.86\%$$

Market size for this year:

$$£1,400,000 + £200,000 = £1.6 \text{ million}$$

Market growth:

$$\text{Old size} = £1.4 \text{ million}$$

$$\text{New size} = £1.6 \text{ million}$$

To work out a percentage increase, use the following formula:

$$\frac{\text{New} - \text{Old}}{\text{Old}} \times 100$$

$$\frac{1.6 - 1.4}{1.4} \times 100 = 14.29\%$$

Choosing the right legal structure for the business

The key factors that influence the choice of legal structure are as follows:

- The **type of liability** that the firm will have – unlimited or limited (Figure 2)

Definition: Unlimited liability means that the personal possessions of the owners of a business must be used to help pay off its debts if it gets into financial difficulty.

Definition: Limited liability means that it is only the owners' investment in the business that is at risk if the firm gets into financial difficulties. Personal possessions are *not* at risk.

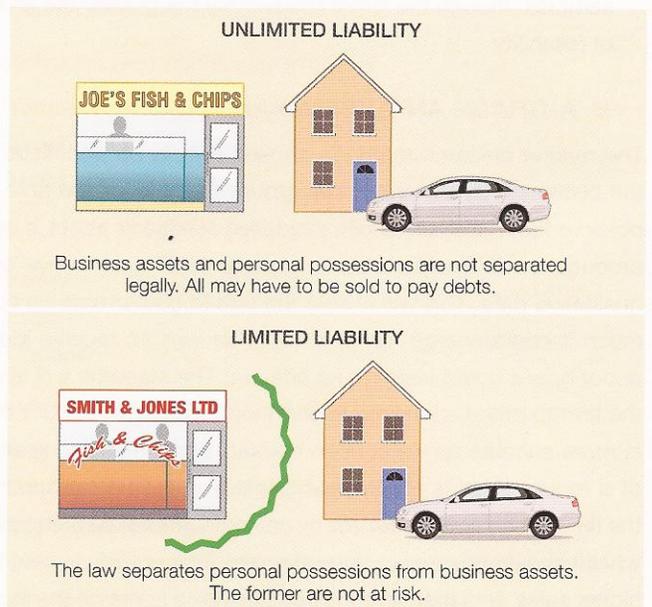


Figure 2 Unlimited liability versus limited liability

- The amount of record keeping required
- The way in which decisions are to be made

Business structures

- Sole trader
- Partnership
- Limited company (private or public)
- Franchise (see p. 3)
- Not-for-profit organisation

Sole trader

A sole trader is the simplest type of business to set up. It requires little administration and involves one person running the business.



Advantages

- ▶ Make all the decisions
- ▶ Keep all the profit
- ▶ Work when you want

Disadvantages

- ▶ Unlimited liability
- ▶ Nobody to share decisions with
- ▶ Unable to raise finance easily
- ▶ When you are not working, no money is being made

Partnership

A partnership is when two or more people (up to a maximum of 20) work together to run the business. Partners will often draw up a deed of partnership to explain partner responsibilities within the firm.

Advantages

- ▶ Can share decisions
- ▶ Specialisation a possibility
- ▶ Extra access to finance
- ▶ Relatively easy to set up

Disadvantages

- ▶ Unlimited liability
- ▶ Possible disputes and disagreements
- ▶ Less formal standing legally
- ▶ Have to share the overall profits (and losses) of the business

Limited company (private or public)

A **private limited company** is a more formal legal structure. Accounts have to be published each year and the owners become shareholders within the business. A private limited company has the letters 'Ltd' after its name and new shareholders can only be invited privately by the other shareholders. **Public limited companies** have more onerous reporting requirements and tend to be larger organisations. These firms can offer shares to the general public via the stock exchange.

Advantages

- ▶ Limited liability
- ▶ Greater standing as a legal entity
- ▶ Greater access to funds through issuing shares

Disadvantages

- ▶ Have to have accounts audited
- ▶ Have to register the business at Companies House
- ▶ Greater running costs
- ▶ More complicated to set up

Not-for-profit organisation

A not-for-profit organisation is typically a social enterprise that is run under business principles but aims to benefit society rather than make a profit. If profits are made, they are normally reinvested back into the business to provide even further benefits to society.

One Water is a good example of a social enterprise.

EXAM TIP

Armed with the advantages and disadvantages of the different types of business ownership, you should be well set to answer a question on this area. Typically you will be asked to explain why the business has moved from a sole trader or partnership to a limited company. This should be relatively easy and the basis of your argument should be around the added benefits of having limited liability in relation to unlimited liability.

Raising finance

A key aspect for any business is how finance is raised to set it up and fund its operation. A business can access two main sources of finance – internal and external.

Internal sources of finance come from within the business or from the owners in the form of:

Retained profits and owners' savings

Advantages

- ▶ Do not have to pay interest – therefore a cheap source
- ▶ Owners retain control

Disadvantages

- ▶ By using money already in the business, the firm will face an opportunity cost – it could have used the finance elsewhere
- ▶ Likely to be only a small amount of finance available at the start of a business
- ▶ Start-up businesses are risky – owners could lose all their savings

Sale of assets/Sale and leaseback

Advantages

- ▶ Certain assets might not be utilised – therefore it makes sense to sell them
- ▶ Can bring in much needed funds in the short term
- ▶ Can keep equipment up to date more readily

Disadvantages

- ▶ Can prove costly in the long term
- ▶ The sell-on cost is likely to be less than the price originally paid

External sources of finance come from outside the organisation in the form of:

Share capital

Advantages

- ▶ Limited liability restricts the amount investors can lose
- ▶ New shareholders might bring additional expertise as well as extra finance
- ▶ Only need to pay shareholders a dividend if the firm is making a profit

Disadvantages

- ▶ As more shares are sold, the original owners might have less control over the business
- ▶ Shareholders will expect both dividends and a say in how the business is run

Bank overdraft

Advantages

- ▶ Very useful short-term source
- ▶ Flexibility – can only use the overdraft when needed
- ▶ Only pay interest when the overdraft is being used
- ▶ Quick and easy to arrange

Disadvantages

- ▶ Can be expensive if used for a long time or for large amounts
- ▶ Will have to pay high interest rates for the time overdraft is being used
- ▶ New businesses may not be offered an overdraft

Bank loan

Advantages

- ▶ The interest rate will be fixed – easier to budget for
- ▶ Can borrow a set amount over a period of years – paid back in regular instalments
- ▶ Guaranteed source of funds if agreed by the bank

Disadvantages

- ▶ Have to pay interest
- ▶ Might not be given
- ▶ A successful firm will have to pay interest on a fixed-term loan that may no longer be needed

Family and friends

Advantages

- ▶ May be a low interest rate
- ▶ Quick and easy to arrange

Disadvantage

- ▶ Blurs social and professional boundaries

Venture capital

Advantages

- ▶ Venture capitalists might provide guidance and support as well as finance
- ▶ Can prove useful if banks do not choose to invest – venture capitalists will often invest in riskier businesses

Disadvantages

- ▶ Venture capitalists often want a large share of the business in return for their investment
- ▶ Venture capitalists can become too controlling over the direction of the business

EXAM TIP

Examiners will look to assess your knowledge of different sources of finance and here you will need to apply your response to the business in question. You should consider whether the source of finance is suitable. It will depend on the following factors:

- ▶ The legal structure of the business – certain sources are only available to limited companies
- ▶ How much finance is required?
- ▶ How risky is the investment?
- ▶ How established is the firm?

You will be expected to discuss the advantages and disadvantages of the chosen source of finance.

A-GRADE ANALYSIS EXAMPLE

The issue of shares is a good source of finance for XYZ Ltd as it increases the amount of capital available. However, new shareholders will have to be invited privately by the firm and it may prove difficult to attract them. They will also expect a share of the profits from the business and may look to become involved in the way the business is run. This will give the original owners less control and may place them under greater pressure. They will need to consider how essential the increased investment is for the business and they need to be careful that it does not limit them in the long term. The extra finance might prove immediately necessary but could have long-term implications.



Locating the business

The choice of location for a business is likely to be critical to its future success. It will depend on a range of factors:

- ▶ Cost of location
- ▶ Closeness to customers
- ▶ Closeness to suppliers
- ▶ Footfall – the number of people that pass by the business each day
- ▶ Infrastructure – road networks, parking
- ▶ Competitors
- ▶ Staffing
- ▶ Government support
- ▶ Technology

▶▶▶▶ A-GRADE ANALYSIS EXAMPLE

A central location will prove beneficial for the restaurant as it will mean it is close to its intended target market, i.e. shoppers and business people who are likely to be looking for a place to eat both at lunchtime and in the evening. While the cost of this location will be higher, the increased footfall should lead to greater interest and subsequent sales that will more than cover the additional cost. Although the restaurant is located close to competitors, the style and quality of its food are sufficiently distinct. This USP combined with its central location should help the firm to build its reputation and establish its brand identity.

Employing people

An entrepreneur must decide on the type of staff required to work in the business and whether they should be:

- ▶ Full time
- ▶ Part time (less than 35 hours per week)
- ▶ Permanent
- ▶ Temporary (employed full time, but for a limited period)

Part time (PT) vs full time (FT)

- ▶ PT work is likely to attract a greater number of job applicants
- ▶ PT workers offer greater flexibility
- ▶ PT workers are often more cost effective – only employed when needed
- ▶ FT workers are often more knowledgeable and have a more detailed understanding of the business
- ▶ FT workers are less likely to leave
- ▶ FT workers tend to have a better level of communication as they work together all of the time

▶▶▶▶ EXAM TIP

Examiners often focus on this area, looking to assess your knowledge of how a new business start-up will employ a mix of part-time and full-time workers. They will most likely expect you to evaluate this in relation to the business. The key factor is the nature of the business, which will determine the type of worker required.

▶▶▶▶ A-GRADE ANALYSIS EXAMPLE

Part-time workers offer a firm greater flexibility in terms of labour needs, and they have fewer rights and less negotiating power than their full-time equivalents. The firm will need to strike a balance between the two types of workers. On the one hand, full-time workers will tend to be more knowledgeable and have a greater understanding of the business and the products that it offers. This may lead to higher customer satisfaction and better relationships between staff and management. However, the use of part-time workers is likely to mean that the firm can better match staffing levels to workload and therefore save costs, leading to a greater profit margin.

▶▶▶▶ A-GRADE EVALUATION EXAMPLE

The employment of full-time and part-time workers will provide the greatest flexibility, as the firm will need a set number of full-time workers operating during the week and can then use more part-time staff at weekends and during busy holiday seasons. This means that the business will be able to maintain the correct number of staff as required by the demand for its products.

A further area to be considered is staff motivation. It could be argued that part-time staff are likely to be more motivated because they will be less bored with the work environment. However, they may lack the expertise and experience that comes from working in the firm full time. In my opinion, as the firm is just starting out, it would make more sense for it to employ a greater number of part-time workers. This is because in the early life of the business, the demand for the product is likely to be harder to predict and therefore the need for workers will also be difficult to calculate. Once sales are more reliable, the firm can look to employ a greater number of full-time staff.

Using consultants and advisers

The business might need to outsource certain activities and make use of specialist help. Consultants and advisers will have expertise and offer skills that the business does not possess, e.g. web design. They will also have experience of working with other businesses and can offer objective advice. However, they may prove expensive.