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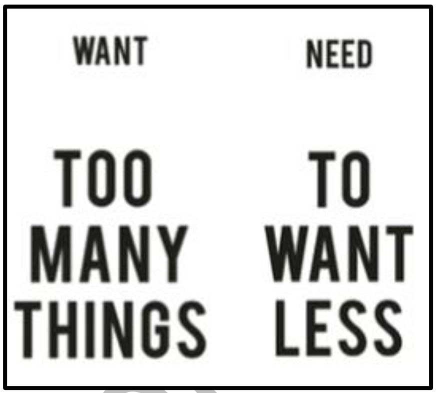
# Cambridge
# IGCSE
# Business Studies
# 0450

## CHAPTER ONE: UNDERSTANDING BUSINESS ACTIVITY




**NAME:**

## 1.1 Business activity
### 1.1.1 The purpose and nature of business activity




- **Needs –** Goods and services (g+s) that are essential for living. E.g. food, shelter, and clothing

- **Wants –** Goods and services (g+s) that people would like to have but are not essential for living. E.g. branded clothing, expensive food, and luxury cars

- **Scarcity** (the economic problem) **–** Resources are limited in relation to our unlimited wants. This necessitates <u>choices</u> and thus incurs <u>opportunity costs</u>.

- **Opportunity Cost –** A benefit/value that must be given up to achieve something else. It is the benefit of the next best alternative given up when consuming or producing another product.

  E.g. if a bakery spends money on a new oven, the opportunity cost of the oven would be the next best item the money could have been be used to buy, such as a new refrigerator to store cakes.

- <u>Purpose of business activity:</u>
  - Combine **factors of production** to **produce g+s**, which are used to **satisfy needs and wants**
  - Pay for factors of production and thus providing **income + employment**, which allows people to consume g+s produced by other people / businesses

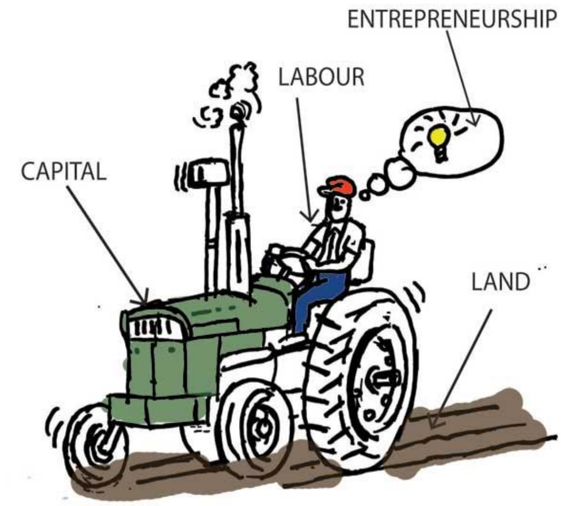
- Business activity:
  - End purpose: usually to make a profit. However, some businesses have non-profit objectives (e.g. charities, government organisations, local sports clubs), funded by donations, membership fees, tax revenues, etc.
  - Businesses also add value to resources by specialisation and also determine what, how, for whom to produce.

- **Profit/Loss = Revenue – Cost**

- Note: “Products” means goods and/or services

- **Factors of production (4) –** productive resources used to make goods and services.

    1. **Land –** Natural resources such as farmland, trees, forests, oil
    2. **Labour –** Human resources i.e. number of workers available to make products
    3. **Capital –** Man-made resources, such as finance, technology, buildings, and machinery, used to manufacture or supply other products
    4. **Enterprise –** The skill and risk-taking of entrepreneurs, who organise factors of production and take risks to produce goods and services.

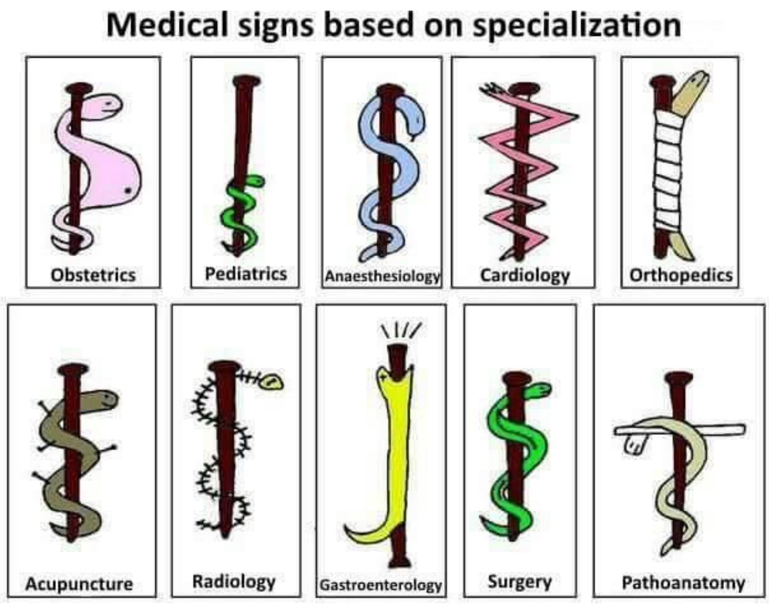





## Importance of Specialisation

- **Specialisation:**
    - Concentration by workers on a particular task in a production process
    - Concentration by workers or businesses in the production of particular G&S
    - E.g. in a car factory, some workers specialise in cutting metal parts, another worker assembles the product, and others paint the car
    - E.g. a bakery only specialises in baking cheesecakes, a teacher only specialises in teaching A-level economics, a doctor specialises in treating children (paediatrician)

- Specialisation helps:
    - **Output**: ↑ amount of g+s that can be produced with scarce resources
    - **Speed**: ↑ speed of production
    - **Quality**: ↑ quality of products
    - **Costs**: ↓/cut costs



- Specialisation is now very common compared to the past (where people were self-sufficient, i.e. they produced everything they needed on their own).
- Specialisation allows the **best use of limited resources and skills**! This increases the efficiency in the allocation and use of resources, which leads to an **increased standard of living.**

Due to repetition (in specialisation):
↑experience = improve skill = ↑efficiency, productivity = ↑output, quality + ↓waste, cost

- **Division of labour:**
    - When the entire production process is divided into different tasks, and each worker is assigned a specific task to work on
    - It is a form of specialisation.


- **Keywords:**
    - Repetition
    - Efficiency
    - Productivity
    - Waste, Cost, Output, Quality
    - Best use of limited resources and skills

| For Workers Only | |
|---|---|
| **Advantages** | **Disadvantages** |
| Specialised workers are more efficient and productive, and thus can command higher wages. | There is the risk of reduced employment opportunities and job security for low-skilled workers as robots can take over their repetitive tasks. |
| **General (Can be adjusted for use with Workers / Businesses)** | |
| **Advantages** | **Disadvantages** |
| Specialised workers, through repetition:<br>- Improved skills + experience<br>- ↑ efficiency, ↑productivity<br>- ↓ wastes, ↓ cost<br>- ↑ product quality, ↑output | Repetition could lead to boredom + ↓ job satisfaction. This may lead to:<br>- ↓efficiency, ↓productivity, ↓quality |
| Less **time** wasted as worker does not need to move from one task to another. | Must rely on other businesses / workers to supply what they don't have or cannot produce. Thus, production is disrupted when:<br>- Specialised workers go on leave/stop working<br>- Businesses of specialised components stop supplying the business / workers |

## Added Value

- <u>Value Added = Selling Price – Material Costs</u>
  - Value added – Difference between selling price of a product and material costs
  - Selling price – Market price paid by consumer (includes all costs and profit)
  - Cost – Natural and man-made materials and components
  - Note: Value added is NOT profit. It includes labour wages (paid for effort and work put in to convert or process materials), but NOT material costs.
- <u>To increase added value:</u>
  - **Increase selling price** → by creating a high-quality image for the good/service so people are willing to pay higher prices, such as through:
    - Advertising
    - High quality packaging
    - Creating a recognised brand
    - Employing experienced/knowledgeable sales staff
    - Decorating the store in an upmarket way (appeal to wealthy customers)
    - NOTE: creating a high-quality image may incur higher costs
  - **Reducing cost of materials** → such as by:
    - Specialisation (more efficient in using resources, reducing waste)
    - Lowering quality (e.g. using cheaper materials)
    - NOTE: lowering quality may make customers unwilling to pay the same price

### 1.2 Classification of businesses

## Economic Sectors

- **Primary Sector:**
  - Industries that specialise in the extraction natural resources to produce raw materials used by other businesses
  - Examples:
    - Fishing
    - Agriculture
    - Mining
    - Oil and gas extraction


- **Secondary Sector:**
  - Industries that specialise in processing and/or using natural resources and raw materials, including **manufacturing, construction, refining, and assembly**
  - Examples:
    - Food processing (e.g. bakeries, manufacturers of fast food, cheese, biscuits, tea, chocolate, etc.)
    - Construction
    - Textile industry (clothes production)
    - Oil and gas refining
    - Manufacturing cars and aircrafts


- **Tertiary Sector:**
  - Industries that specialise in the provision of services to consumers and other sectors of the industry
  - Examples:
    - Healthcare (e.g. nurses)
    - Legal services (e.g. lawyers)
    - Entertainment (e.g. singers, dancers)
    - Education (e.g. teachers)
    - Financial services (e.g. banking, accountancy)
    - Repairs (e.g. plumbers, tailors)
    - Insurance
    - Tourism
    - Hairdressing
    - Wholesaling and retailing

## Types of Economies

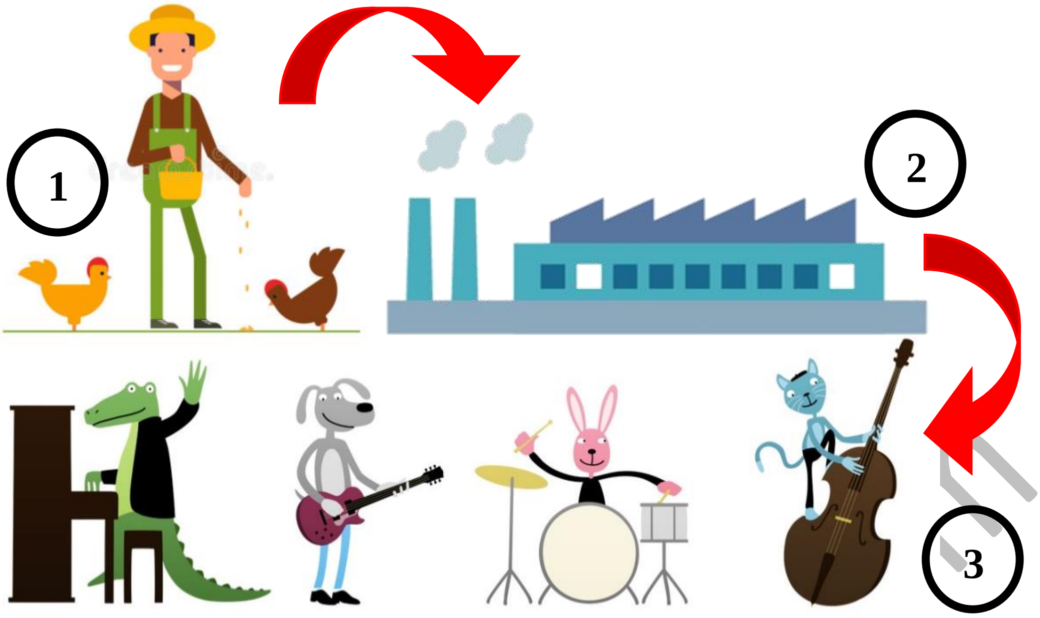
| | Developed economies | Newly industrialised economies (Rapidly developing) | Developing economies (Less developed) |
|---|---|---|---|
| **Economic sectors, in terms of output + employment** | | | |
| Primary sector | Small | Large but shrinking (esp. agriculture) | Large (major employer) |
| Manufacturing sector (secondary) | Declining | Expanding rapidly | Small |
| Service sector (tertiary) | Significantly expanded | Growing | Small, growing slowly |
| **Standard of living** | | | |
| Income + standard of living (which affects **demand** for g+s) | Generally good (Large proportion of income spent on services) | Improving generally | Poor |
| Amount + variety of goods and services | Great amount<br>Wide variety | Growing quickly | Few |
| Examples of countries | Australia, France, Singapore, USA, UK | Brazil, China, India, Malaysia, Thailand | |

## Changes in sector importance

- **De-industrialisation –** the decline in the manufacturing sector in a country (accompanied by the growth of the service sector)

- Relative importance of each sector (compared to each other) is determined by:
  - Output (compared to national output)
  - Employment (percentage of total workforce)

- Changes in the **relative importance** of the 3 sectors:
  - Initially, the primary sector is of greatest relative importance (highest output + employment).
  - Then, the relative importance of the manufacturing / secondary sector increases, compared to the primary sector.
  - Then, many tertiary sector industries begin to expand more rapidly than those in the primary and secondary sectors.




- Reasons for changes in the relative importance of the 3 sectors:
  - **Depletion of natural resources (primary sector resources):**
    - Natural resources, e.g. timber, oil, gas, and precious metals
    - Due to: overfishing, excessive deforestation and mining, etc.
  - **Loss of international competitiveness (in manufacturing):**
    - Developed economies are less competitive in manufacturing than newly industrialised countries like China / India, where wages (labour costs) are low.
  - **Higher proportion of incomes spent on services**:
    - Occurs when:
      Total wealth of a country ↑ + standard of living ↑ + people become wealthier
    - Consumers tend to spend a higher proportion of their incomes on services, like travel, entertainment, and restaurants, instead of just spending on basic needs and manufactured and primary products




"If we're moving towards a service economy, why won't you mow the lawn?"

**1.2.2 Private and Public Sectors in a Mixed Economy**

# Market Economy / Free Market Economy

- Features:
  - All resources are privately owned by people and firms.
  - Every business will aim to maximise profit, i.e. profit is the main motive.
  - There is consumer sovereignty → Consumers control producers! Wants and needs of consumers control the output and decisions of producers (vs producer sovereignty).
  - Firms will only produce goods which consumers want and are willing to pay for (less wastage / surpluses / shortages).
  - Price is determined through the price mechanism (demand and supply).
  - E.g. Hong Kong and Singapore are among the freest in the world (but not 100%)

- Advantages:
  - Market economies respond quickly to people's wants
  - There is a wide variety of goods and services in the market.
  - New, better methods of production (innovation) encouraged, leading to lower costs.

- Disadvantages:
  - Public goods may not be provided for, so the government will have to interfere to provide these types of goods through funding from taxes, e.g. streetlights.
  - Market economies encourage consumption of harmful goods/demerit goods.
  - Prices keep changing as they are determined by demand and supply.
  - Social costs may not be considered while producing goods and services (e.g. not eco-friendly)

# Planned Economy / Command Economy

- Features:
  - Government decides how all scarce resources are to be used.
  - Government decides what and how much to produce and the price to charge for g+s.
  - Public sector and the government play an important economic role.
  - E.g. North Korea, Cuba, (China was a command economy turned mixed economy)

- Advantages:
  - No competition between firms, thus resulting in less wastage (like through unnecessary advertising).
  - Government helps ensure that everybody is employed (aim: full employment).
  - Smaller gap between the poor and rich (a more equal distribution of wealth).

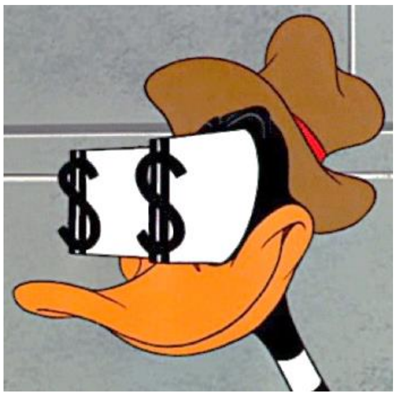
- Disadvantages:
  - No incentives for businesses to produce and innovate.
  - No consumer sovereignty as the production of goods is decided by government.
  - Businesses usually are less efficient because of lack of the profit motive.
  - May have large surpluses/shortages of certain g+s (because hard for the government alone to realise the needs of everyone (vs. price mechanism / demand and supply).

# Mixed Economy – Private and Public Sector

- Features:
  - A mixed economy is a combination of the market economy and government planning (has features of both economies), which allows it benefit from and avoid problems that arise from being on one side of the spectrum (either market or planned only).
  - Has both the **private sector** and **public sector**, i.e. some businesses are owned by private individuals, some by the government.
  - Note: Most countries in the world are mixed economies, e.g. UK, USA, France

| | Private Enterprises | Public Enterprises |
|---|---|---|
| Ownership + Control | Private sector: private individuals | Public sector: government-owned or state-owned |
| Main objective | Maximise profit | Non-profit<br>Provide essential + beneficial services for all citizens (even if not profitable) |

- **Private Sector:**
  - Decisions are made by business themselves. (But there is likely to be still some government control over these decisions)
  - Advantages → due to the profit motive:
    - Efficient production and use of scarce resources: cut costs and wastes
    - Innovation (of products and production methods): cut costs, boost sales and profit
    - Competition: helps lower prices + improve quality
    - Quick response to changes in consumer wants and spending patterns (demand)
    - Wide variety of g+s produced: to satisfy consumer wants (demand)
  - Disadvantages:
    - Reduced employment (to cut costs)
    - Less likely to focus on social objectives and benefit to society (e.g. eco-friendly)
    - High prices for essential services (maximise profit due to price inelastic demand)
    - No production of certain essential / beneficial g+s just because it is not profitable



- **Public Sector:**
  - Decisions made by the government and public authorities.
    Some goods and services are free of charge, highly subsidised, or still produced even if they are not profitable. Funding comes from taxes (taxpayers).
    E.g. public transport, state healthcare, education, electricity + water supply, defence
  - Public sector enterprises may be receive support (e.g. subsidies) OR able to run on their own and make a profit.
  - Public sector organisations:
    - Government authorities (e.g. inland revenue / taxation department)
    - Government agencies (e.g. intelligence agency, food standards agency)
    - Public corporations (like businesses) (e.g. hospital, central bank)

- **Privatisation**:
  - The selling or transferring of public sector businesses to the private sector
  - Purpose: to benefit from the **efficiency** of the private sector (advantages)
  - In many European and Asian countries, the water supply, electricity supply, and public transport systems have been privatised.
  - Advantages of reducing the size of the public sector (privatisation):
    - More efficient allocation + use of limited resources = cut costs, increase output
    - Less government funding and burden on taxpayers
    - Lower prices and higher quality, due to more competition for customer and sales
    - Private sector firms respond to new business opportunities and create more jobs, income, and output
  - Opposite: **nationalised** businesses – once owned by private individuals but bought by the government

- Note: "Decisions" include what to produce, how to produce, what price to charge

**1.3 Enterprise, business growth and size**
**1.3.1 – Enterprise and entrepreneurship**

## Entrepreneurs

- **Entrepreneur –** A person who takes risks and make decisions needed to organise resources to produce goods and services and to start and operate a business venture.

| Advantages | Disadvantages |
|---|---|
| Make use of personal ideas, skills, and interest | Risk of failure, especially with poor planning |
| Independence: choose how to use time and money | Increased responsibility |
| Increased motivation | Longer hours of work |
| Potential to earn higher incomes (than regular employees) | No steady income from regular employment in another business (opportunity cost) |
| May become famous and successful if their business prospers | Need to invest own money and possibly also find other sources of capital |


- **<u>Characteristics of successful entrepreneurs:</u>**

| | |
|---|---|
| **Hard-working** | Long hours of work and on weekends and holidays → needed for success |
| **Risk-taker** | Willing to take risks, unafraid of failure |
| **Innovative** | Generate ideas to stay ahead of the competition |
| **Confident** | Clear belief in own abilities and ideas → needed to be convincing to stakeholders, like banks and investors |
| **Effective communicator** | Share ideas clearly and confidently with investors, employees, and other stake holders + in promotions and advertising |
| **Able to learn from others + self** | Learn from mistakes, ideas, and achievements of others and themselves |
| **Self-motivated (+ independence and perseverance)** | (Motivation, independence, and perseverance) To overcome problems and the tough initial stages on their own and continue |

## Business Plans

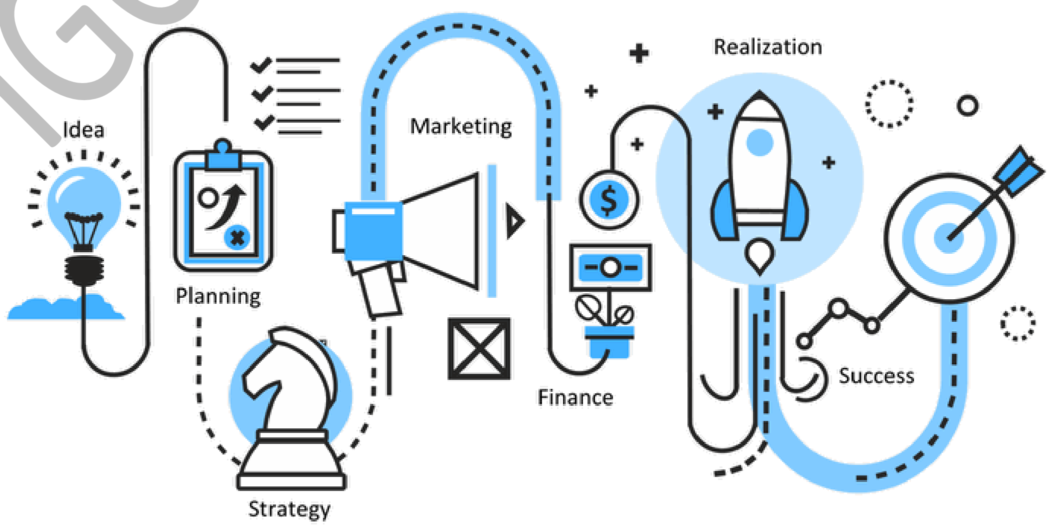
- **Business plan –** A written statement about the business proposal, with important information about the business, such as its objectives, strategies, products, market, and financial plans and projections

- <u>**Functions of a business plan:**</u>
  - **Support an application for external funding** (e.g. applying for bank loans, to convince investors)
  - **Reduce risk of business failure** by allowing the entrepreneur to:
    - Assess how successful and reasonable the business idea is
    - Organise ideas + identify lacking information + have a focus
    - Set out the objectives and how and when to achieve it
  - **A standard by which to measure progress and success** in a business



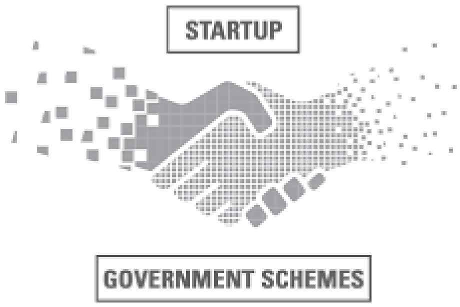
"Any other collateral besides your heart of gold and million-dollar smile?"

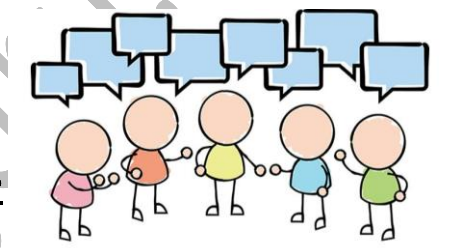
- <u>**Contents of a business plan:**</u>
  - **Objectives** → goals the business wants to achieve
  - **Product description** → goods/services offered by business
  - **Production plan** → what factors of production (land, labour, capital) are required, where (location) and how to produce
  - **Market assessment** → target customers, competitors, pricing strategy, market potential (estimated total maximum sales) of a product
  - **Financial plans and projections** → source of finance, projected (estimated / predicted) financial statements



# Government Support for Business Start-Ups

- **WHY do governments support business start-ups?**
  Reasons → business start-ups benefit the society + economy because they:
  - **Reduce unemployment:** by creating jobs / employment opportunities
  - **Increase competition:** leading to lower prices, more choices, higher quality products that benefit consumers
  - **Have potential and can boost economic growth:** start-ups have the potential to grow further and become important to the economy, leading to an increase in the output of goods and services, innovations, new products and markets, etc.
  - **Benefit society:** some entrepreneurs start social enterprises that offer benefits to society other than jobs and profits (e.g. protect environment + disadvantaged people)

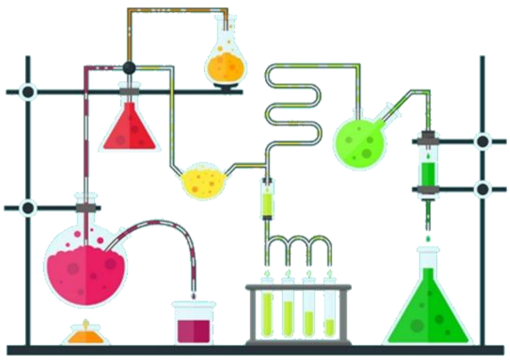


- **HOW do governments support business start-ups?**
  Examples of supports:
  - **Grants:** non-repayable sums (esp. in areas of high unemployment), which helps to offset costs such as training for employees
  - **Low-cost loans**: sums repayable at a low interest rate
  - **Low-cost premises (land)**
  - **Free business advice and support:** from experienced entrepreneurs
  - **Training schemes**: to boost employee productivity, skills, experience, employability
  - **Public university research facilities**: made available to new entrepreneurs

- Purpose of these supports:

  - Offset business costs
  - Reduce risk of financial failure
  - Provide relevant skills and knowledge required in starting and running a business
  - Boosting productivity and efficiency
  - Boost profits and returns → sustainability
- Note: Government support may not be available everywhere and may be conditional (e.g. only for research and development, green technologies, starting up in high unemployment areas).



### 1.3.2 – Methods and problems of measuring business size

## Measuring Business Size

- **Stakeholder –** any person or group with a direct interest in the performance and activities of a business

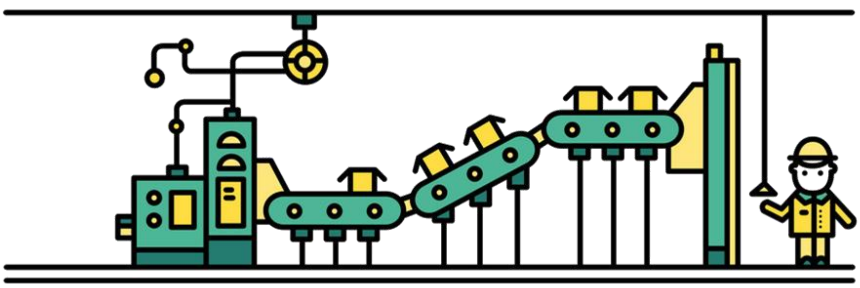
- Why is it necessary to measure business size?
  <u>Stakeholders</u> who find it useful:
  - **Business owners:** compare their size and important to competitors
  - **Governments:** to set different tax rates on the profits of large and smaller businesses
  - **Investors:** helps decide which business to invest their money in for good returns
  - **Workers:** to have an idea how many people they may be working with
  - **Banks:** whether firms are big enough to take out a loan / make repayments
  - **Consumer representatives:** concerned about the power some larger firms have over price and quality

**<u>Methods to measure business size + their limitations:</u>**

- Note → **<u>PROFIT</u> is <u>NOT</u>** a method of measuring business size!

1. **NUMBER OF EMPLOYEES** → easy to calculate and compare with competitors
   <u>Limitations</u>:
   - **Different production method:** Some businesses can produce higher output with fewer employees, e.g. capital-intensive firms, compared to labour-intensive firms that may have many employees but a smaller output.
   - **Part-time employees:** Some businesses hire many part-time workers (shorter work hours); some businesses hire fewer full-time workers; but the total hours worked by employees and total output may be similar.

2. **VALUE OF CAPITAL EMPLOYED** → easy to calculate and compare with competitors
   <u>Limitations</u>:
   - **Different production method:** similar to "number of employees" method → not accurate when comparing labour-intensive VS. capital intensive production methods



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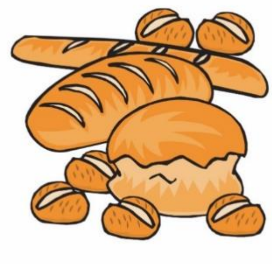
3. **VALUE OF OUTPUT/SALES →** for businesses in the same industry (especially in manufacturing industries), easy to calculate and compare with competitors
   Limitations:
   - **Different value of products:** Some businesses may be very small but producing very expensive / luxury products while a very large factory with many workers may be producing a lot of cheap clothing, but the value of their output may be similar.

**VS.**

**RM 2,000 x 1** **RM 20 x 100**

4. **VOLUME OF OUTPUT/SALES →** easy to calculate and compare with competitors
   Limitations:
   - The size of a bakery (thousands of breads a year) cannot be accurately compared to the size of a shipbuilding company (few ships a year) using this method.



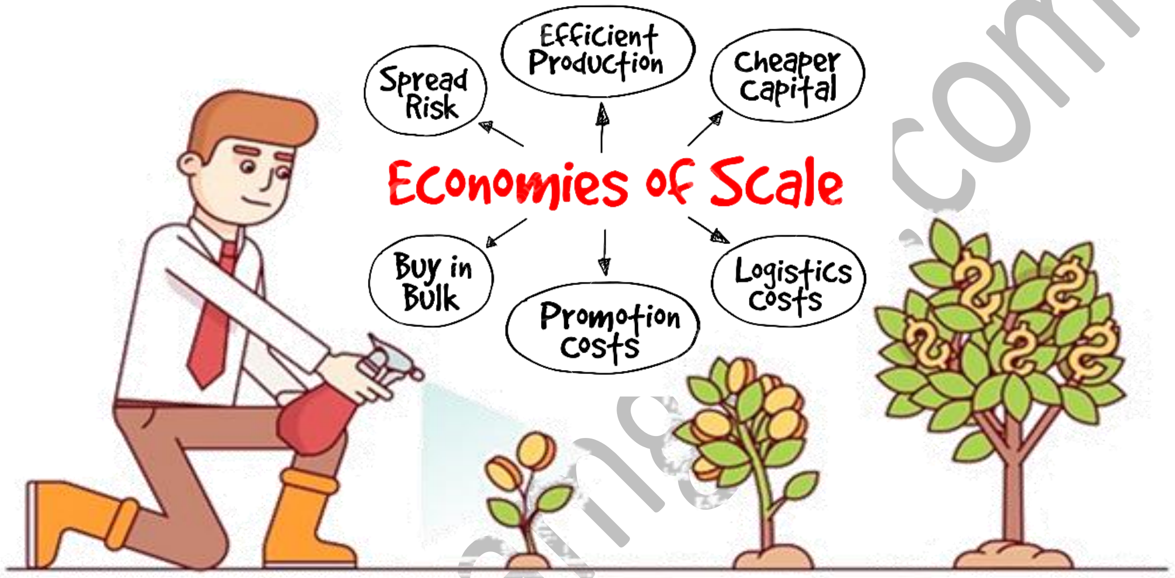
**VS.**

5. **MARKET SHARE:**
   Limitations:
   - **Markets differ in size** (not all markets are big): the only local salon may be a small business but capture a very major share of the small, local market (i.e. large market share), compared to a big multinational corporation with a small market share in a giant global market

- **Conclusion:**
  - There is no single, perfect way of comparing business size
  - A more useful option would be to:
    **use a few methods + compare results**

### 1.3.3 – Why some businesses grow and other remain small

- Benefits of growth and expansion (why owners want to expand their businesses):
  - **Possibility of higher profits**
  - **More status and prestige:** for owners + employees, often with higher salaries as well
  - **Economies of scale:** lower costs due to increased output, price discounts from bulk buying, etc.
  - **More and easier financing:** e.g. easier to take out loans as banks are more willing to loan and at a lower interest rate
  - **Hold a larger share of its market**: attracts consumers (being a 'big name' in the industry) + gives the business more negotiating power (with suppliers and distributors)



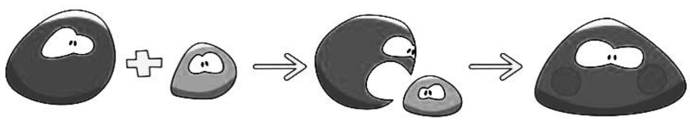

## Types / Methods of Business Growth

- **Internal or organic growth:**
  - Internal or organic growth – involves a firm expanding its own existing operations, by increasing either the quantity or quality of its factors of production
  - Internal growth is often quite slow but easier to manage than external growth.
  - Examples:
    - Expand range of products offered
    - Open new shops/outlets in different locations
    - Investing in technology to increase production capacity / output
    - Exporting (sell products to international markets)

- **External growth:**
  - External growth – involves <u>integration</u> through mergers or takeovers/acquisitions
  - Integration – when two or more businesses join, through either
    - **Merger:** when two or more firms join to form a new, larger enterprise
    - **Takeover/Acquisition:** when one company buys enough shares in the ownership of another company and so obtains full control over that company

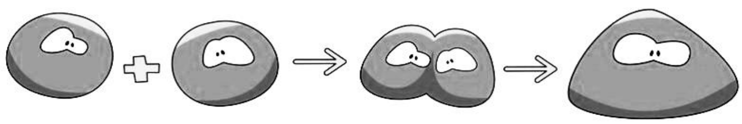
**Extra info:**

| Merger | Takeover / Acquisition |
|---|---|
| Two businesses join | Larger, acquiring business takes over another smaller business |
| Forms a new, joint organisation with new ownership and management | Goes by the old name and rules of the acquiring business, and the smaller business ceases to exist |
| Usually no cash involved | Large amounts of cash required from the buyer |
| Dilutes each company's individual control (shared) | The acquiring business gains full control over the management of the other business |
| A friendly purchase | A hostile purchase |



Acquisition

## Types of Integration



Merger

- **Horizontal integration:**
  - A merger or takeover of firms in the same industry and at the **same stage of production**
  - E.g. a merger between restaurants
- <u>Benefits:</u>
  - Larger market share
  - Reduces number of competitors
  - Economies of scale → cost advantages, due to combined size (e.g. merge the administration departments and reduce staff and other costs, price discounts from bulk buying)

- **Vertical integration:**
  - A merger or takeover of firms in same industry but at **different stages of production**
  - 2 types of vertical integration:
    - **Forward vertical integration:** when a firm integrates with another firm that is at a <u>later</u> stage of production, i.e. closer to consumers
      E.g. a sugar farm merges with a candy factory

    - **Backward vertical integration:** when a firm integrates with another firm that is at an <u>earlier</u> stage of production, i.e. closer to raw material supplies, for manufacturing firms
      E.g. a clothing and textiles manufacturer takes over a cotton farm

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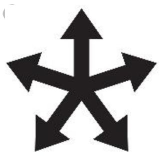
- <u>Benefits (vertical integration, cont.):</u>
  - **Generally** (for a manufacturing firm):
    - Self-sufficiency and independence → more control over supplies (earlier stage) and/or the distribution of its products (later stage) = no need to depend on other businesses for earlier / later stages of production
    - Business absorbs profit margin from earlier (supplier) / later (retailer) stages of production

  - **Specifically** (benefits):

| Forward vertical integration (get a retailer) | Backward vertical integration (get a supplier) |
|---|---|
| Assured outlet / retailer for their product | Assured supply of important components |
| Business absorbs profit margin of retailer | Business absorbs profit margin of supplier |
| Prevent retailer from selling rival products | Prevent supplier from supplying to rivals |
| Direct access to consumers = obtain info about consumer needs + preferences | More control over costs of components + supplies |



- **Lateral/Conglomerate integration** (aka **conglomerate merger**)
  - A merger or takeover between firms in **completely different industries**, a process known as **diversification** (having activities in more than one industry)

  - Creates firms called **conglomerates**, which are corporations that produce a wide range of different and unrelated products
    E.g. Sime Darby (= motors, healthcare, insurance, etc.), Google (= search engine, internet services like email, Google Maps, driverless cars), Samsung (= smartphones, ships, construction, food processing, retail, financial products, etc.)

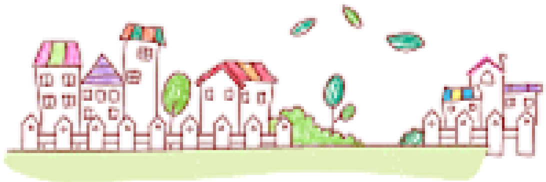
  - <u>Benefits:</u>
    - Diversification spreads risk → less risk of business being greatly affected by falling consumer demand for any of its products, e.g. if the income from Sime Darby hospitals have fallen, Sime Darby can still depend on the sales from its motors division (dealing with the assembly and selling of cars)
    - Sharing of ideas and innovations between different businesses, e.g. an insurance firm taking over an advertising agency could benefit from better promotion of insurance products due to the new ideas of the advertising agency

Google SAMSUNG Sime Darby

## Problems Linked to Business Growth

| Potential problems | Solutions |
|---|---|
| Main issue: diseconomies of scale = production problems, higher costs, lower profits | |
| Cumbersome management, harder to control business | Operate business in small units + allowing local managers to have more control (decentralisation) |
| High expansion costs, business lacks finance | Expand more slowly + use business profits and obtain enough long-term finance |
| Poor communication (too large, different management styles) | Operate business in small units (decentralisation) + use latest communication technologies + ensure efficient communication between managers and workers |
| May experience shortages that disrupt production due to need for huge quantities of supplies | Integrate with a major supplier + stockpile supplies |

## Why Some Businesses Remain Small



- **Their market size is small:**
  - Limited number of customers:
    - Stores in small towns
    - Firms producing specialised g+s = appeal to few customers (a niche market), e.g. luxury fashion items
  - The most efficient size for a firm is closely related to its market size.
- **Personal touch required in certain types of industries:**
  - Firms in these industries offer personal services or specialised products, e.g. plumbers, caterers
  - E.g. a hair salon depends on its connection with regular customers and won't be able to offer personal services if they grow too large
- **Personal choice (owner's own objectives):**
  - Keep full control of their business
  - Know all employees and customers personally
  - Save time + reduce stress (needed to run a larger business)
  - Lower taxes for smaller firms
- **Limited access to capital:**
  - Hard to obtain a loan / expensive loan interest
  - Insufficient savings and incomes

**1.3.4 – Why some businesses fail**

## Business Failure


- <u>Causes of business failure:</u>
  - **<u>Poor management</u> + bad decisions –** by inexperienced managers
  - **Poor financial management –** leads to <u>liquidity problems</u> (cash shortages), uncontrolled and high costs, losses, and debts that disrupt business operation
  - **Expanding too much too quickly –** leads to problems in management and finance as well as diseconomies of scale
  - **Failure to adapt to <u>changes in business environment</u> –** businesses have to plan as best it can to adapt to changes in business environment, such as:
    - Economic recession
    - Technological changes → outdated business products and production processes
    - New competition
    - Changes in consumer preferences
    - Changes in laws + regulations (e.g. higher interest rates mean higher cost of borrowing, more stringent quality controls mean higher costs)


- <u>NEW businesses are at GREATER risk of failing (than established businesses) because:</u>
  - **Lack of skills and experience –** lead to problems like poor management and selecting wrong locations to operate the business
  - **Failure to research and plan –** lesser demand and more competition than expected, changes in consumer consumption patterns, etc.
  - **Lack of financing –** reduces the competitiveness of the business due to poor-quality premises, outdated equipment, inadequate promotions, etc.

- Making losses does NOT always mean business failure → consider these reasons:
  - As the business invests to expand and increase sales, it may face temporary losses in the short run, but this may increase profitability in the long run.
  - There may have been changes, like changes in technology or consumer preferences. The business may face losses at first and take time to adapt before it can return to being profitable.

### 1.4 Types of business organisation

#### 1.4.1 The Main features of different forms of business organisation

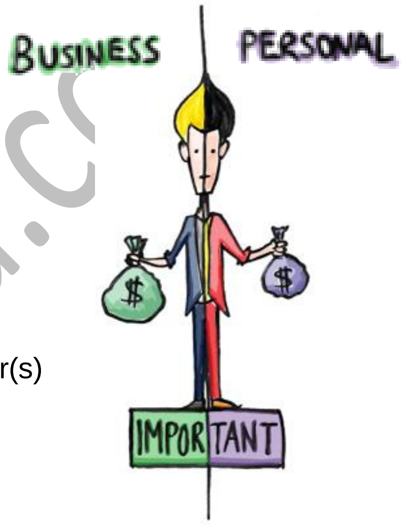
## Types of Business Organisations

- Keywords / Criteria (for type of business organisation):
  - O – ownership → owners bear profits + control + risks + responsibilities (PCRR)
  - L – liability (risk) → limited and unlimited
  - C – control → management, handle problems and coordination
  - F – financing → fixed and working capital

- Terms:

  - **An unincorporated business**:
    - Does not have a separate legal identity from its owner(s)
    - Owners have unlimited liability
    - Types: sole trader / proprietor, partnership

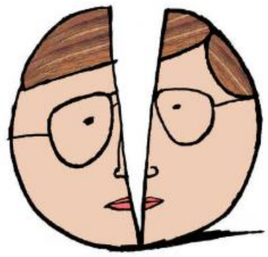
  - **An incorporated business:**
    - Is a separate legal identity from its owner(s) / shareholder(s)
    - Owners have limited liability
    - Types: private limited company, public limited company




  - **Unlimited liability:**
    - Means owners are personally responsible for all debts of the business
    - The liability of the owners is not limited just to what they invested in the business
    - Note: owners can be declared bankrupt if they cannot repay all debts even using their own personal money

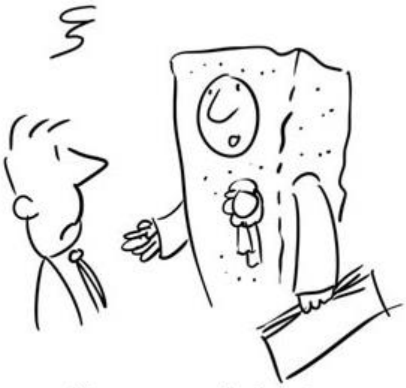
  - **Limited liability:**
    - Means the legal responsibility of the shareholders in a company to repay its debts is only limited to the amount they invested into the company
    - Shareholders are not personally responsible for the business.
    - Note: whatever happens, the most the owners can lose is (limited to) only what they have invested

- **Risk (liability):**
  - Having the same legal identity as the business means the owners have greater financial + legal risk (than owners with a business that is a separate legal entity)
  - Financial risk = unlimited liability for the debts of the business
  - Legal risk = owner can be sued for damages from business's activities + products



- **Divorce between ownership and control:**
  - Occurs in limited companies / incorporated businesses
  - Ownership = owned by shareholders
  - Control = management + decision-making is done by <u>board of directors + managers</u>
  - Disadvantage:
    Directors and managers may run the business to meet their own objectives, e.g. they may use their business expansion plans to justify higher salaries for themselves and reduced dividends for shareholders (in the name of "funding expansion")
  - Shareholders may have no influence except that they could vote to replace the directors at the next AGM.

## Unincorporated Businesses



"I represent the business community - I'm a sole trader."

- <u>Sole trader:</u>
  - O – one owner, bears all PCRR alone (owners can employ people, but employees are not owners)
  - L – unlimited liability
  - C – completely control by owner (management, decision-making, etc.)
  - F – banks are usually unwilling to loan as it is considered a risky enterprise

| Advantages | Disadvantages |
|---|---|
| Simple, easy, and not expensive to set up: due to few legal requirements and low start-up capital required | Lack of capital and financing for expansion, limited to owner's savings, profits, and small bank loans |
| Owner has full control and freedom: no need to consult others when making decisions like choosing holidays, prices, and employees | Full responsibility and control: may mean long work hours and no one to discuss business matters with |
| Owner receives all profits after tax and so has the incentive to work hard | Unlimited liability: fully responsible for debts and may have to sell own possessions to pay the debts if the business cannot pay |
| Personal contact with customers: increases customer loyalty, owner able to respond quickly to changes in demand | Owner may lack the necessary skills and experience for success |
| Don't have to share business matters, can keep business plans + financial details private | Business legally stops existing after the owner dies (i.e. no continuity). |

- Partnerships:
  - O – 2-20 owners sharing the PORR
  - L – unlimited liability
  - C – partners share in management and decision-making
  - F – more finance as partners can contribute capital
  - Popular among **professionals**, e.g. accountants, lawyers, doctors
  - Optional but recommended to draw up a **partnership agreement** (written and legal agreement between partners) before starting the partnership to avoid unnecessary disagreements in the future (e.g. profit-sharing, who invests more capital)
  - Limited liability partnerships (LLPs):
    - Limited liability for partners
    - Separate legal unit which still exists after a partner's death
    - Partners still retain right to manage business directly (unlike incorporated businesses)

| Advantages | Disadvantages |
|---|---|
| Simple and easy to set up: few legal requirements | If one partner is inefficient or dishonest, other partners have to suffer the costs |
| More capital invested: more financing from partners to allow expansion | Business growth is limited to the amount of capital 20 partners can bring in |
| Shared work, responsibilities, and losses, and one on leave can be covered by other partners | Disagreements on business decisions, slower decision-making as partners have to discuss |
| New skills and ideas shared between partners, and partners could specialise in different tasks | Unlimited liability: partners responsible to repay debts of the partnership, even by selling their own properties and using personal money |
| | Business legally stops existing if one partner dies (i.e. no continuity). |




"You make a good point; we both hate the cat. I'm just not sure what it is you'd bring to a partnership."

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## Incorporated Businesses / Limited Companies

- Limited companies:
  - O – companies are owned by people who have invested in the business by buying shares in the company, i.e. shareholders
  - F – receive financing by selling shares to raise capital
  - C – management and decision-making by <u>board of directors + managers</u>, who may or may not be shareholders
  - Dividend – payment to shareholders taken from profits after tax as returns on their investment in the company
  - Incorporated businesses – separate legal entity from owners:
    - Can own assets and borrow money in its own right
    - Can be taken to court + held responsible for any damage caused by its activities
    - There is continuity (i.e. it can continue to exist) even if a shareholder dies
  - AGM – limited companies are required by law to hold annual general meetings (AGM) every year with shareholders
  - Prices of shares – reflect profitability + performance of business
  - Note: “companies” can only be used to refer to incorporated businesses




- <u>Private limited companies:</u>
  - O – 2-200 shareholders
  - L – limited liability
  - C – management and decision-making by board of directors + managers
  - F – more finance as partners can contribute capital
  - Shares – cannot be offered to the general public; can only be sold privately + with agreement of other shareholders
  - Note – advantage compared to public limited companies as private limited companies cheaper to set up

(Private limited companies, cont.)

| Advantages | Disadvantages |
|---|---|
| Raise significant capital for expansion through sale of shares (up to 200 shareholders) | Shares cannot be offered to the general public, and so very huge capital for further rapid expansion may not be obtainable |
| Limited liability for shareholders (less risk) | Shares can only be sold privately with the agreement of other shareholders, so people may be unwilling to invest as they cannot sell shares quickly if they want their money back |
| Shareholders receive dividend (from profits after tax) | Legal requirements and detailed documents: harder to set up and operate |
| Continuity even if a shareholder dies | Must keep detailed accounts and publish them publicly (extra costs + less privacy) |

- Public limited companies:
  - O – there is no maximum limit of shareholders
  - L – limited liability
  - C – management by board of directors, not shareholders
  - F – more finance as partners can contribute capital
  - Shares – issued for sale to the general public on the stock exchange / stock market, advertised to the general public through a prospectus

| Advantages | Disadvantages |
|---|---|
| Can raise very huge capital for rapid expansion: can sell shares to general public and no limit on shareholders | Complicated and time-consuming legal requirements to set up |
| Limited liability for shareholders (less risk) | Many more regulations and controls to protect the shareholders, e.g. less privacy as it must publish accounts, must hold AGMs with shareholders |
| High status: easier to attract suppliers to sell on credit, banks more willing to lend money | Divorce of ownership and control: directors and managers may not run the company for the benefit of the shareholders |
| Continuity even if a shareholder dies | Selling shares to the public is expensive as it may need a specialist merchant bank and the printing of thousands of copies of prospectus |
| | Original owners may lose overall control they do not keep at least 51% of all company shares (e.g. takeover / acquisition) |

| | Sole trader | Partnership | Private limited company | Public limited company |
|---|---|---|---|---|
| **Ownership** | One person | Several partners | Shareholders – few or many, but shares cannot be sold to general public | Shareholders – many, no maximum limit |
| **Profits and control** | One owner (**advantage**!) | Shared (disadvantage) | | |
| **Risk: losses + responsibility** | One owner (disadvantage) | Shared (**advantage**!) | Maximum risk and responsibility for shareholders is up to what they have invested (**advantage**!) | |
| **Separate legal entity** | Unincorporated = unlimited liability + no continuity after owner dies (disadvantage) | | Incorporated = limited liability + there is continuity even after a shareholder dies (**advantage**!) | |
| **Set-up + operation** | Few legal requirements<br>Low start-up capital<br>Few controls and regulations<br>(**advantage**!) | | Many legal requirements<br>Many controls and regulations<br>Required to publish accounts<br>(disadvantage) | |

## Other Private Sector Business Organisations

- <u>Joint ventures:</u>
    - An agreement between two or more businesses to share their capital, risks, costs, profits, expertise, and management in the running of their new business project
    - May be dissolved (ended) once project completed
    - Common – overseas companies form a joint venture with local companies that have good knowledge of the local culture, customer tastes, and regulations

| Advantages | Disadvantages |
|---|---|
| Shared costs + risk | Shared profits, and shared ideas that may give one business an advantage in the future |
| Each business gains access to the expertise, technologies, and customers of the other, e.g. one business has local knowledge as it is based in the country where the joint venture is set up | Disagreements over important decisions like management. Clashes if businesses have very different cultures / management styles. |
| Advantages due to increased size and market share, such as cost-savings from economies of scale | |

- <u>Franchise:</u>
    - A business that distributes the products and uses the brand names, logos, and strategies of an existing successful business
    - Many well-known international businesses use franchising to expand into new **overseas markets** → combine large, well-known brand name + local knowledge of franchisees
    - Franchisor:
        - Existing business, usually well-known, with an established brand name and market for its products
        - Provides franchisee with staff training, supplies, equipment, promotional materials
        - Monitors the performance of the franchisee
    - Franchisee:
        - Buys the licence to operate the franchisor's business and use its brand name, production methods, and promotional materials
        - Pays the franchisor an initial fee and a regular royalty fee (usually a percentage of revenue)

| **To the franchisor** | |
|---|---|
| **Advantages** | **Disadvantages** |
| Faster way of expanding the business (franchisor does not have to finance all outlets) | Franchisee keeps most profits they make from their outlets |
| Licence and royalty fees from franchisee | Bad reputation for the whole business, if one franchisee fails to maintain good-quality goods and level of service |
| Products and supplies need to be bought by the franchisee | |
| Management responsibility and costs minimised as franchisees manage their own outlets | |
| **To the franchisee** | |
| **Advantages** | **Disadvantages** |
| Reduce risk of business failure as the brand name is established and well-known | Pay licence and royalty fees (a percentage of revenue) |
| Less decision-making because franchisor has decided the prices, product range, and store layout | Less control compared to an independent business, cannot make certain decisions, e.g. cannot make new products to suit local area |
| A single source (the franchisor) provides supplies, advertising, and training for staff and management | Performance regularly monitored by franchisor |
| Easier to obtain bank loans as franchises are seen as less risky | |

## Business Organisations in the Public Sector


- Public sector enterprises:
  - Organisations owned + controlled by government authorities
  - Some may be supported (e.g. subsidies). Some are expected to make a profit. E.g. national airlines, electricity supply, government schools, local libraries
  - Refer back to "mixed economy", "public sector", and "privatisation"

- <u>Public corporations:</u>
  - Business-like organisations owned by the state / central government
  - Separate legal entity from **government** and **board of directors** (BOD)
  - Government: sets objectives and appoints BOD to manage the business.
    BOD: manages the business according to objectives set by government.
  - Financing:
    - Corporations providing essential services – may be subsidised by the government so the essential services are affordable to everyone regardless of income, e.g. postal services, water and electricity
    - Profitable public corporations – run like a business, and their profits may be used for themselves through reinvestment OR by the government (to pay for public expenditure)
  - Purpose:
    - Carry out government functions, e.g. central bank
    - Provide essential public services, e.g. public hospitals
    - Carry out commercial activities on behalf of government, e.g. state-owned airlines

| Advantages | Disadvantages |
|---|---|
| Safeguard the supply of essential services, even if it's not profitable, e.g. electricity generation | Subsidised by government + not required to maximise profit, which may lead to laziness and inefficiency in management |
| Provide important public services, even if it's not profitable, e.g. public transport, public broadcasting | Often no or little competition, so lack incentive to provide good service and a wide variety of choices to consumers |
| Protect industries important to the country, such as a major employer (to secure jobs for the people) | Used for political purposes, such as to create more jobs before an election (boost popularity of the politician) |
| Natural monopolies (e.g. railway companies) can be owned by the government to ensure consumers are not taken advantage of | |

**1.5 Business objectives and stakeholder objectives**
**1.5.1 – Businesses can have several objectives and their importance can change**
**1.5.3 – Differences in the objectives of private sector and public sector enterprises**

## Business Objectives (Private VS. Public Sector Enterprises)


- Business objectives:
  - Targets that the business works towards
  - Different for each business
  - Private sector objectives, most commonly:
    - Survival
    - Profit
    - Returns to shareholders
    - Growth
    - Market share
    - Service to society
  - Public sector objectives, most commonly:
    - Quality targets
    - Financial targets
    - Social objectives
    - Environmental objectives

- <u>Importance of business objectives → provides:</u>
  - Clear and measurable goals, which motivate and unite workers and managers
  - Focus when planning and making decisions
  - Way of measuring business performance and progress

## Business Objectives

- <u>Survival:</u>
  - May become the most important objective:
    - For newly set-up businesses
    - During economic recessions (unemployment rises, consumer spending falls)
    - For established businesses that feel threatened by new competition

- Profit (Profitability):
  - Profits are needed to:
    - Pay a **return** to owners / shareholders for capital invested + risk taken
    - Provide **financing** for reinvestment in business and daily operations
    - Profitability indicates business success, which helps to secure more capital, such as low-cost bank loans and attracting new investors
  - How to increase profit? Business may have to increase total sales, e.g. by capturing larger market share through advertising. This may lead to initial losses but greater profits in the long run.
  - Some aim for profit maximisation, but it may cause problems such as too much work or too much tax paid to government. Most owners aim for a satisfactory level of profit, or a more long-term and sustainable profit maximisation and growth.

"And we all lived profitably after."

- Increasing returns to shareholders:
  - Some managers of limited companies set this as an objective to discourage shareholders from selling their shares, which helps managers keep their jobs.
  - How?
    - By increasing profit, to increase dividends paid to shareholders
    - By increasing share price (i.e. the shares of the shareholders will be worth a greater value), such as by helping the business to grow and become more successful and profitable

- Growth (e.g. in sales, profit, market share):
  - Possible reasons:
    - Cost advantages (economies of scale)
    - Obtain larger market share and so increase sales
    - Spread business risk through diversification (by moving into new products and markets)
    - Increase status and salaries of managers
    - Increase job security

- <u>Market share:</u>
    - Market share – the proportion of total market sales of a product / business
    - Can be achieved through heavy advertising / penetration pricing
    - May lead to retaliation from rival firms, which could increase costs and reduce profits
    - Possible reasons:
        - Good publicity and reputation (e.g. 'most popular')
        - More power over suppliers = can negotiate generous discounts + exclusive deals
        - Reduce threat of competition (dominate market) = more control over price setting

- <u>Service to society:</u>
    - **Social enterprises –** set up and operated by private individuals (private sector) but with not just financial but also social and environmental objectives
    - <u>Objectives of social enterprises:</u>
        - **Social:** provide jobs + support for the disadvantaged (e.g. disabled, homeless)
        - **Environmental:** protect the natural environment (e.g. wildlife, oceans)
        - **Financial:** earn profit for reinvestment to expand its social work


- Business objectives often **change** over time. Possible situations:
    - An economic recession may cause a profit-oriented business to set the short-term objective of survival
    - Changes in technology (e.g. in production processes) may cause some owners to sacrifice short-term profits for long-term survival and profits
    - Business has achieved an objective, e.g. surviving well for a few years, and may now shift its focus to other objectives, e.g. higher profits

- **Public sector enterprises:**
  - Can be profitable OR unprofitable (e.g. subsidised to produce very low-cost g+s)
  - Usually don't have to worry about **survival** as the government can intervene to sustain it and prevent it from closing down (this can lead to inefficiency and laziness as managers and workers become complacent)
  - Objectives are usually NOT to maximise profit but rather to benefit the wider community and **increase standard of living** (e.g. employment, good quality public services, and increased output and choice of goods and services). Any profits are used to benefit society through reinvestment or government spending.

- <u>Public sector objectives, most commonly:</u>
  - **Quality targets** (good-quality public services):
    - Beneficial and essential services to society and economy, e.g. public healthcare, education, libraries, police, public transport
    - Meet quality targets set by government, such as improving waiting times, safety, satisfaction, etc.
  - **Financial targets:**
    - Control and reduce running costs and being cost-efficient
    - Meet profit targets set by government → profits for reinvestment OR for government to use
  - **Social objectives:**
    - Protect and increase employment, esp. in certain poor regions of low employment
    - Support the disadvantaged, e.g. disabled, poor, sick
  - **Environmental objectives:**
    - Reduce use of energy, water, paper, etc.
    - Some public sector organisations are specifically set up for environmental objectives, e.g. conserve flora and fauna, control pollution and deforestation

### 1.5.2 – The role of stakeholder groups involved in business activity

## Internal and External Stakeholders

- **Stakeholder –** any person or group with a direct interest in the performance and activities of a business (note: they are affected by (benefit from / get harmed by) and so try to influence the objectives and actions of the business)

- Internal stakeholders (work for / own the business):
  - Owners / Shareholders
  - Managers
  - Employees / Workers
- External stakeholders (outside of the business):
  - Consumers
  - Government
  - Creditors (e.g. banks)
  - The wider community / society

| | **Features + Importance** | **Objectives** |
|---|---|---|
| **Owners / Shareholders** | - Risk-takers<br>- Invest capital to set up + expand business<br>- Lose money if business fails + Share any profits from success | - Earn a good profit = good return on investments<br>- Business growth = to increase value of their investment |
| **Employees / Workers** | - Develop, produce, and sell g+s<br>- Employed by business on a part- or full-time basis, paid wages/salaries<br>- Follow instructions of managers<br>- May need training for efficiency<br>- If unsatisfied = strikes can increase costs and disrupt production | - Regular and reasonable wages<br>- Good and safe working conditions<br>- Job security<br>- Job satisfaction and motivation |
| **Managers** | - Employees that control other employees<br>- Make important decisions<br>- Determine success or failure for the business | - Job security and high salaries<br>- Business growth = to increase their status + power + salaries |
| **Consumers** | - Buy g+s of business (if not enough customers, business would fail)<br>- Note: Most successful businesses conduct market research = important to find out consumer preferences | - Safe and reliable products<br>- Value for money<br>- Good quality<br>- Good customer and after-sales service and maintenance<br>- Some concerned: business activity does not harm the environment |
| **Government** | - Control country's economy<br>- Pass laws to protect workers, consumers, and the environment (laws may increase business cost)<br>- Influence overall demand and controls, such as through taxes | - Want successful business as they will employ workers, pay taxes, and increase country's output |
| **Banks (a creditor)** | - Provide finance for business's operations | - Expect business to repay capital loaned + interest (business must remain liquid) |
| **Wider community** | - Interested in how business activity affects community, e.g. benefits from g+s and employment, harm from pollution and dangerous products<br>- Can form pressure groups against business activities that harm them / the environment | - Improve their standard of living<br>- Employment and income<br>- Safe and environmentally friendly products<br>- Treat employees fairly |

## Conflicts Between Stakeholder Objectives

- The objectives of stakeholders may **CONFLICT** with each other, e.g.:
  - Managers want to build a factory to grow the business
    Local community is against this as it may increase pollution and noise in the area
  - Managers want to introduce new machinery to cut costs and increase profits
    Local community + employees against it as it would reduce jobs in the business
  - Owners want to use cheaper, low-quality materials to lower costs and increase profits
    Consumers are against this as product quality will be lowered

- Life is not as simple as setting one objective and achieving it.
  Businesses often must satisfy the objectives of more than one group of stakeholders.
  Therefore, managers have to:
  - **Compromise** when deciding best business objectives → it is bad for survival and reputation to ignore the concerns and objectives of other stakeholders
  - **Prepare to change** objectives over time → depending on many factors, such as economic conditions (e.g. switching objective from growth to survival during economic recessions)

# Revision exercises:

## RESOURCES ARE SCARCE

(1)________________ are important because they are used to make goods, like television, cars, and houses, and to provide (2)________________, like banking, insurance, and transport. All of these resources are (3)________________. Any resources that are not scarce are called (4)________________. Wants are (5)________________ but the resources used to produce the goods and services to satisfy these wants are (6)________________. That is, there is (7)________________. (8)________________ is necessary because scarce resources can be used in lots of ways to make different goods and services. The real cost of choosing one thing and not another is known as the (9)________________

**Clues:**
choice, free goods, limited, opportunity cost, resources, scarce, scarcity, service, unlimited

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## MARKET ECONOMY

In a (1) __________________ consumers decide which (2)__________________ they want and businesses provide them. Almost all the businesses in the market economy are (3)__________________ owned. There is (4) __________________ sovereignty. Wide varieties of goods are produced and there is freedom of choice. (5)__________________ are controlled through the price mechanism. In other words, prices of goods and services are determined by their (6) __________________ and (7)__________________. Most of the factors of (8)__________________ i.e. land, labour, capital are privately owned.

The main advantages of Market economy include- Encouragement to (9)__________________ to come up with new ideas. Competition between businesses encourages greater (10)__________________ and better utilisation of scarce (11)__________________. On the other hand, if there is no profit businesses will not provide goods and services. (12)__________________ can be created which might control the prices in the market.

**Clues**:
consumer, demand, efficiency, entrepreneurs, goods and services, market economy, monopolies, prices, privately, production, resources, supply

## PLANNED ECONOMY

In a (1)____________ economy, all the (2)____________ are owned by the State. In these economies, decisions on what to produce, how much to produce and for whom to produce is taken by the (3)____________. These economies are also called (4)____________ economies. Only one sector exists and that is (5)____________ sector. The main advantages of this economic system are that the resources are used to produce only those goods and services which are needed by the (6)____________ and thus eliminate wasteful (7)____________. Equal (8)____________ of income and wealth is possible. On the other hand, due to the lack of competition, firms may lose their (9)____________ and there may not be optimum utilisation of resources. There is less freedom of choice for the consumers as most of the (10)____________ decisions are taken by the government.

**Clues:**
command community competition distribution efficiency government planned production public resources

## DEMERIT GOODS AND MERIT GOODS

(1)______________ goods are goods which are deemed to be (2)______________ undesirable, and which are likely to be over-produced and (3)______________-consumed through the market mechanism. Examples of demerit goods are cigarettes, alcohol and all other addictive drugs such as heroine and cocaine.

The consumption of demerit goods imposes considerable negative (4)______________ on society as a whole, such that the private (5)______________ incurred by the individual consumer are less than the (6)______________ costs experienced by society in general; for example, cigarette smokers not only damage their own health, but also impose a cost on society in terms of those who involuntarily passively smoke and the additional cost to the National Health Service in dealing with smoking-related diseases. Thus, the price that (7)______________ pay for a packet of cigarettes is not related to the social costs to which they give rise i.e. the marginal social cost will exceed the market price and (8)______________ and over-consumption will occur, causing a misallocation of society's scarce (9)______________.

(10)______________ goods confer benefits on society in excess of the benefits conferred on individual consumers; in other words, there is a divergence between private and social costs and benefits, as the social benefits accruing to society as a whole from the consumption of such goods tend to be greater than the private benefits to the individual. This divergence means that the private market cannot be relied upon to ensure an (11)______________ allocation of society's scarce resources. The problem is that individual consumers and producers make their decisions on the basis of their own, internal costs and benefits, but, from the standpoint of the (12)______________ of society at large, externalities must be considered.

**Clues:**
consumers, costs, demerit, efficient, externalities, merit, over, over production, resources, social, socially, welfare.

## Public Limited Company

A Public Limited Company has (1)____________________________ at the end of its name, distinguishing it from a (2)____________________________ limited company. These shares of most public limited companies are bought and sold through the (3)____________________________. The shareholders have (4)____________________________ and can be held responsible only for payments up to the value of their shares. Like the private limited company, public company has its own (5)____________________________ status separate from the shareholders. The procedure for setting up a public limited company starts with submitting (6)____________________________, document stating the company's name and address of the company along with the (7)____________________________ giving details about how the company will be run. The (8)____________________________ will issue a (9)____________________________. After this the company can issue a (10)____________________________- an advertisement inviting the public to buy shares in the company. When the shares have been issued the Registrar of Companies will draw up a (11)____________________________; this allows the company to start trading.

**Clues:**
Article of Association, Certificate of Incorporation, Certificate of Trading, legal, limited liability, Memorandum of Association, plc, private, Prospectus, Registrar of Companies, Stock Exchange