

# STUDENT'S BOOK



Cambridge IGCSE™  
and O Level

## Business

Sixth Edition

Karen Borrington  
Peter Stimpson

Sample

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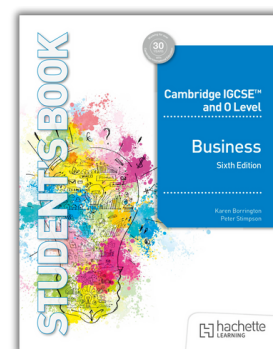
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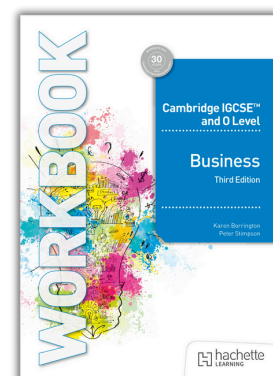


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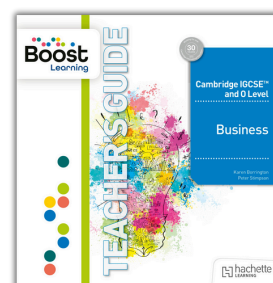


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# Business activity and economic sectors

This chapter will explain:

The nature of business activity:

- ★ factors of production: land, labour, capital and enterprise
- ★ the concept of adding value and how added value can be increased
- ★ the concept of opportunity cost.

Types of economic sector:

- ★ primary, secondary and tertiary sectors
- ★ private and public sectors.



## Definitions to learn

A **business** is an organisation that combines factors of production to make products (goods and services) which satisfy people's wants.

**Goods** are tangible products made by businesses to be sold to customers, such as cars and clothes.

**Services** are intangible products, such as banking or transport, that are provided by businesses to customers.

**Factors of production** are those resources needed to produce goods or services. There are four factors of production and they are in limited supply.

## The nature of business activity

What would life be like without **business** activity? In a simple economy, businesses do not exist. Everyone attempts to do everything for themselves – they are self-sufficient. With their own plot of land and by their own efforts, such as hunting and farming, they attempt to survive and produce enough for their own needs. This is a very basic existence and living standards are low.

Through the slow process of specialisation, people began to concentrate on what they were best at. They then traded the **goods** they produced for other goods, such as shoes, made by people who had different skills. In this way, businesses began to be formed, and trade and exchange of goods expanded. In today's world, most people specialise by working in one job for a weekly or monthly wage. With this money, they are able to purchase a wide range of goods and **services** produced by many different businesses that specialise in different products. Many businesses specialise in producing one or just a few types of goods or services.

Business activity therefore:

- » **combines scarce factors of production** to make or provide goods and services
- » **produces goods and services** which satisfy the needs and wants of the population
- » **employs people** as workers and pays them wages to allow them to consume products made by other people working for other businesses.

## Factors of production

To produce these goods and services, businesses need 'factors of production'. There are four **factors of production**:

- » **Land** – this term includes all of the natural resources provided by nature that are used in the production of goods and services. This includes fields and forests, oil, gas, metals and other mineral resources.
- » **Labour** – this is the number of people available to make products and the skills they have.
- » **Capital** – this is the finance, machinery and equipment needed for the manufacture of goods or the provision of services.



## 1 BUSINESS ACTIVITY AND ECONOMIC SECTORS

### Study tips

Definitions of the key terms in this book can be found in the left-hand margins.

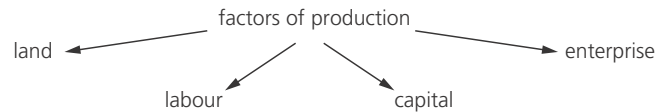
These definitions will be very useful to you as you study the course, so it is important that you learn these by heart.

### Definitions to learn

**Capital** is the money invested into a business by the owners.

» **Enterprise** – this is the skill and risk-taking ability of the person who brings the other resources or factors of production together to produce a good or service, for example, the owner of a business. These people are called entrepreneurs. See Chapter 2 to understand the role of entrepreneurs.

Whatever their size and whoever owns them, all businesses have one thing in common: in order to produce goods and services that satisfy customer needs, they must combine these four factor of production.



In any one country, and in the world as a whole, these factors of production are limited in supply. As there is never enough land, labour, **capital** or enterprise to produce all the needs and unlimited wants of a whole population, there is an economic problem of scarcity.

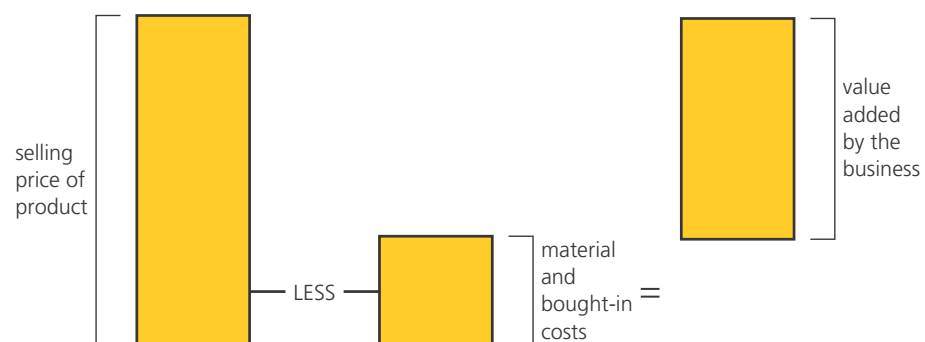


▲ Businesses in all economic sectors produce goods and services by combining factors of production

## The concept of adding value

This is a very important idea. All businesses attempt to add value. This is done by selling a product for more than the cost of materials and resources used to produce the good or provide the service. If value is not added to the materials and components that a business buys in, then:

- » other costs cannot be paid for
- » no profit will be made
- » the business is likely to fail.



▲ Value added

**Definitions to learn**

**Added value** is the difference between the selling price of a product and the cost of bought-in materials and resources needed to produce it.

**Key info**

Children around the world are playing with more mini LEGO® people than there are human beings on the planet. The LEGO Group adds value by putting LEGO bricks into themed building sets, such as spaceships or superheroes. Some sets are also linked to successful movie series such as Harry Potter and Marvel's Avengers. When the LEGO Star Wars *Summer Vacation* movie was released, it further strengthened the brand and encouraged consumers to pay a high price for the building sets.

**Study tips**

Apply your answers to the business in the question. Adding value will be achieved by different businesses in different ways. Improving the reliability of cars will lead to a better brand image for the car manufacturer which could allow it to raise prices. An internet service provider might focus on achieving the highest rating for customer service in the industry. Increased customer loyalty resulting from this will add value. The costs of attracting new customers will fall.

Example:

- » The selling price of a newly built house is \$200 000.
- » The value of the bought-in bricks, cement, wood and other materials was \$35 000.
- » The added value of the building firm was \$165 000. This is not all profit – out of this the builder must pay wages and other costs too.

Why adding value is important

**Added value** is important because revenue from selling the product is greater than the cost of materials and resources bought in by the business. This means the business:

- » can pay other costs such as labour costs, management expenses, advertising and power
- » may be able to make a profit if these other costs come to a total that is less than the added value
- » may be able to grow, as a profit will provide the finance for expansion.

## How added value can be increased

There are two main ways in which a business can try to increase its added value.

- 1 Finding ways to charge a higher price for the product, such as:
  - creating an effective brand image that customers are prepared to pay higher prices to own. This could be done by advertising the product with celebrities or by having very innovative products
  - adding a new feature to the product that costs less than the increase in price
  - improving customer service, for example, by offering free delivery. Again, the cost of this must be less than the price increase
  - improving packaging, which gives the product a much higher quality image.
- 2 Reducing the cost of materials, such as by:
  - using a lower-cost supplier of materials and keeping the price the same. Customers must not experience a reduction in quality or they may think the product has fallen in value
  - buying supplies in larger quantities to obtain bulk discounts which reduce cost per unit. However, this could lead to higher storage costs.

### Extend your skills of analysis

**A question which asks how a bicycle manufacturer could increase added value to its products could be answered as follows:**

*Trying to give the products a more sports-focused brand image by promoting the fastest models with well-known sportspeople could help add value.*

**Extend your analysis by explaining how this helps the business improve its brand image.**

*Consumers link the bicycle to the well-known sports stars and associate a better, faster performance with the brand image. If they hope they will also improve their performance when using the bicycle, consumers may be prepared to pay a higher price.*

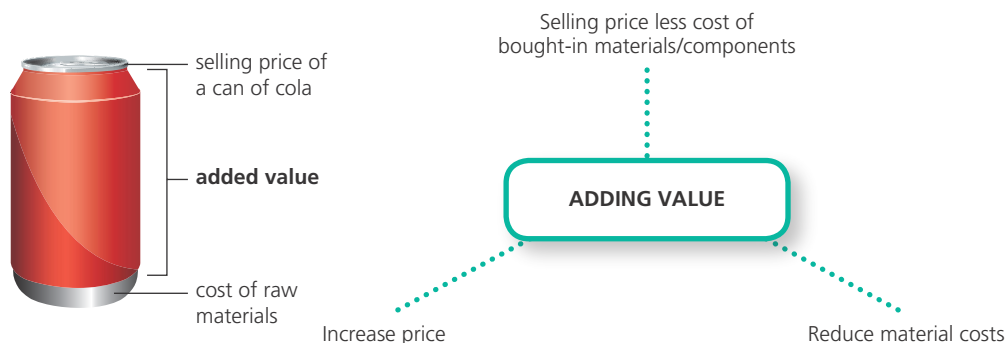
**Extend your analysis by explaining how this increases added value for the business.**

*By being able to charge higher prices, the bicycle manufacturer will be increasing the difference between the price charged and the cost of the materials used to make the bicycles.*

## 1 BUSINESS ACTIVITY AND ECONOMIC SECTORS

### REVISION SUMMARY

#### Adding value



### Case study: Rakesh's bakery

Rakesh owns a small bakery selling bread, cakes and biscuits. His business is just making enough money to survive. His wife, Neeta, had the idea of serving customers tea and coffee at 2 small tables that could be fitted into the bakery shop. 'Customers will pay more for each cake and biscuit if we sell them with tea or coffee – just like a little cafe.' Rakesh bought some second-hand cafe equipment and furniture and tried what Neeta had suggested. She was right! Some of his customers not only bought teas and coffees, but they paid higher prices for the cakes and biscuits they bought as they were served them on a plate!

Rakesh had increased the value added to the flour, sugar and butter he used to make these cakes and biscuits.

### Activity 1.1

Refer to the case study above.

- If the bestselling cake in this bakery uses 50 cents worth of flour, sugar and butter and Rakesh sells each one for \$1.50, calculate the value added.
- If customers are prepared to pay \$2.00 when this cake is served on a plate at a table within the bakery, what is the new value added per cake?
- Does the opening of the small cafe mean that Rakesh must have increased his weekly profit? Explain your answer.



### Case study: Starbucks

Starbucks adds value in several ways, not just by selling coffee.

- It has a brand image for quality, environmental awareness and social responsibility. It sells high-quality coffee that is ethically sourced.
- Customers can personalise their drinks with different milk options, syrups, flavouring and toppings.
- Starbucks cafes are designed to be spaces to relax, socialise, work or study. The cafes have comfortable seating and provide access to free Wi-Fi.

All of these things allow Starbucks to charge a much higher price for its drinks and other products than the prices charged by many other cafes.





**Definitions to learn**

**Opportunity cost** is the value of the next best alternative given up when choosing one option over another.

## The concept of opportunity cost

Have you bought anything this week? A pen or book or perhaps a pizza? If you have, you have experienced **opportunity cost**. By choosing what to buy, you had to give up buying other goods and services. Why? Because, unless you are unbelievably rich, you have limited resources. To be precise, opportunity cost means the next most desired product you would have bought if you had not bought that pen, book or pizza – or whatever you chose. So, by buying a book – assuming this was your choice – you gave up the chance of buying the product you next most desired. This was your opportunity cost – it is the value of what you did not choose.

Opportunity cost always occurs when choices are made about the use of limited resources. All economic decision makers – individuals, businesses and governments – will experience opportunity cost when they decide how to allocate the limited resources at their disposal.

### Individual



Holiday or car?



If the individual chooses to buy the holiday, the value of the car becomes the opportunity cost.

### Business



Machine A or Machine B?



If the company decides to buy Machine A, the value of Machine B becomes the opportunity cost.

### Government



New road or new school?



If the government chooses to build the road, the value of the school becomes the opportunity cost.

▲ Examples of opportunity cost

## Types of economic sectors




### Primary, secondary and tertiary sectors

The production of all goods and services can be split into three types of business activity. Many products pass through all three sectors as they are converted from unprocessed materials into goods and services for customers to buy. As you read this book you are probably sitting at a table. Many tables are made of wood. How many different types of business activities have been involved in converting trees into a finished table ready to be sold to the final customer? What 'economic

## 1 BUSINESS ACTIVITY AND ECONOMIC SECTORS

sectors' – or stages of production – has the wood from trees passed through to arrive at the finished table?

The diagram below shows the most likely stages in the production and sale of a wooden table.

stage	activity	business involved
primary		woodcutter
secondary		furniture maker
tertiary		retailer

▲ The stages involved in making and selling a wooden table

You will notice that there are three main stages from the cutting down of the tree to the sale of the completed table. These stages are typical of the production of nearly all tangible goods and they are called economic sectors.

**Stage 1** is called the primary stage of production. This stage involves the Earth's natural resources. Activities in the **primary sector** of industry include farming, fishing, forestry and the extraction of natural materials, such as oil and copper ore. All businesses that operate in these industries are in the primary sector.

**Stage 2** is called the secondary stage of production. This stage involves taking the materials and resources provided by the primary sector and converting them into manufactured or processed goods. Activities in the **secondary sector** of industry include building and construction, aircraft and car manufacturing, mobile phone assembly and bread baking. All manufacturing businesses operate in the secondary sector.

**Stage 3** is called the tertiary stage of production. This stage involves providing goods and services to both consumers and other businesses. Activities in the **tertiary sector** of industry include transport, banking, retailing, insurance, hotels, entertainment (e.g. film making, music, theatre) and hairdressing. All service providers operate in the tertiary sector.

### Definitions to learn

The **primary sector** of industry extracts and uses the natural resources from the Earth to produce raw materials used by other businesses.

The **secondary sector** of industry manufactures goods using the raw materials provided by the primary sector.

The **tertiary sector** of industry provides goods and services to consumers and the other economic sectors.



▲ The three types of economic sector: rice farming in Vietnam, clothes production in China and retailing in Kenya

### Activity 1.2

Copy this table. Indicate with a tick which economic sector each business is in.

Business	Primary	Secondary	Tertiary
Insurance			
Forestry			
Lithium mining			
Electronics equipment assembly			
Airline			
Bakery			
Housebuilder			

#### Study tips

If you are asked which economic sector(s) a business operates in, do not forget that many businesses operate in more than one!

Many businesses do not limit their operations to just one economic sector. For example, a few large UK supermarket groups own their own farms, producing, for example, milk (primary activity). They process farm output in their own factories to make finished goods such as yoghurt (secondary activity). They then sell these goods in their own retail stores (tertiary activity). Such businesses often claim that there are advantages in being able to control all the suppliers of these products.

## Private and public sectors

Nearly every country in the world has an economy which combines both a private sector and a public sector.

### Private sector

The **private sector** is made up of businesses that are not owned by the government but by private individuals. The individuals who own these businesses will make their own decisions about what to produce, how it should be produced and what price should be charged for it. Most businesses in the private sector will aim to make a profit. Even so, there are likely to be some government controls over these decisions and these are explained in later chapters in this book.

#### Definitions to learn

The **private sector** is the part of the economy owned and operated by individuals and companies, usually for profit, and is not state/government controlled.

### Potential advantages of private sector businesses

- » Owners of private sector businesses will aim to make a profit – this will encourage owners to operate the business as efficiently as possible to reduce costs and not waste resources.
- » Customers are likely to benefit from competition between private sector businesses. Competition should help to keep prices low and customer service levels high, as well as encourage the business to introduce new products to increase demand.
- » The profit motive encourages entrepreneurs to set up new businesses which creates new products and a dynamic business environment.

### Potential disadvantages of private sector businesses

- » Owners may agree with competitors to fix prices and make higher than normal profits.
- » Some businesses might become so large that they dominate their industries as monopolies. This again could lead to high prices and high profits.
- » Many important goods and services will not be provided to everyone – only those customers who can afford them. If there are only a small number of potential customers for a product, then it may not be profitable for businesses to produce it.

### Public sector

#### Definitions to learn

The **public sector** is made up of organisations in the economy that are owned and controlled by the government.

The **public sector** is made up of government (or state) owned and controlled businesses and organisations. The government, or other public sector authority, makes decisions about what to produce and how much to charge consumers. Some goods and services are provided free of charge to the consumer in many countries, such as state health care and education services. The money for these comes not from the customers but from taxpayers. The objectives of private sector and public sector businesses are often different.

### Potential advantages of public sector businesses

- » Private monopolies will be prevented from making higher than normal profits, if a profit is made at all.
- » Some important goods and services can be provided to all people who need them as consumption will not depend on ability to pay.
- » Government ownership and control may mean that the business organisation takes decisions that benefit the whole community. These might include using low polluting production methods.

### Potential disadvantages of public sector businesses

- » The cost of providing important goods and services to everyone will be high. This may lead to high taxation.
- » Public sector businesses may operate with social objectives and not the profit motive as the key aim. This might mean that they are less efficient and more wasteful than private sector businesses.
- » The lack of competition in an industry in the public sector may lead to less innovation and few new products being developed.

Which business activities are usually in the public sector?

In many countries the government owns and controls the following important industries or activities:

- » health
- » education
- » defence
- » public transport
- » water supply
- » electricity supply.

### Activity 1.3

For each of the examples of key industries or activities listed above, suggest **three** possible reasons why the government of a country might decide to own and control that industry or service.

### Activity 1.4

Find out whether, in your own country, the government owns and controls the following businesses:

- |                      |                         |
|----------------------|-------------------------|
| a railway system     | e TV and radio stations |
| b local bus services | f hospitals             |
| c water supply       | g libraries.            |
| d electricity supply |                         |

### Extend your skills of analysis



**A question which asks why a government might want to improve the economy by encouraging expansion of the private sector, such as car manufacturing, could be answered as follows:**

Expanding the private sector will result in more car manufacturers owned and controlled by private individuals and not the government.

**Extend your analysis by explaining what will happen if the private sector grows.**

More private sector businesses will mean more competition and more new cars produced.

**Extend your analysis by explaining how this will help the economy.**

More competition should encourage businesses to keep car prices as low as possible to encourage sales. Competing businesses will also want to bring out new products and this should increase jobs and output in the economy.

### Study tips

The advantages and disadvantages of both the private sector and public sector are important to remember.

### Activity 1.5

A government is considering moving the postal service from being in the public sector to being in the private sector (privatisation). You decide to write to the government minister in charge, explaining your views on this matter and stating your opinion. Your letter should contain:

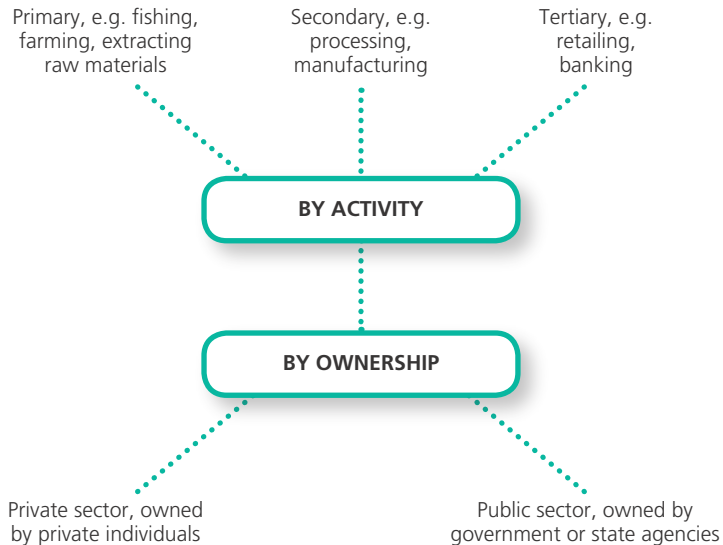
- an explanation of the difference between private sector businesses and public sector businesses
- the possible advantages of the postal service being in the private sector
- the possible disadvantages of the postal service being in the private sector
- your recommendation to the minister on whether to keep the postal service in the public sector or not.



## 1 BUSINESS ACTIVITY AND ECONOMIC SECTORS

### REVISION SUMMARY

#### Economic sectors



### International business in focus

#### Tourism in Mauritius

Mauritius is a small island in the Indian Ocean with a land area of just 2000 km<sup>2</sup>. The Mauritian economy is dominated by the tertiary sector. In 2023 tourism, finance and other services accounted for approximately 66% of total national output (gross domestic product). In contrast, the secondary sector accounted for 18% and primary industries – mainly sugar production – approximately 3%. The government is planning for up to 1.5 million visitors from other countries. These tourists spend a great deal of money on food, drink, travel and holiday gifts.



Air Mauritius is one of the businesses that has benefited greatly from the expansion of tourism in the country. The airline is partly owned by private owners and the Mauritian government. It has been nominated in the 'Best Airline in Africa' category in recent years.

Air Mauritius not only has an extensive network of air routes but it also offers services to other airlines operating in the region. There are hundreds of hotels and guesthouses in Mauritius and these employ many local workers. Some of the largest hotel groups in the world operate in Mauritius, including Radisson and Hilton.

#### Discussion points

- Why do you think the primary sector of the Mauritian economy is relatively small?
- Explain three ways in which tertiary sector industries contribute to the Mauritian economy.
- Do you think that increasing numbers of tourists will bring only benefits to Mauritius?
- Why do you think the Mauritian government still owns a part of Air Mauritius?

## ? Chapter review questions: Short answer and data response

- 1 Ade's Engineering Company (AEC) operates in the secondary sector. It uses the 4 factors of production to make parts for cars and trucks. These goods are sold to car and truck manufacturers in many countries. The parts include metal brake components and rubber seals to fit around windows. To be successful, AEC requires raw materials supplied by other businesses to make car parts.
  - a Define 'goods'. [2]
  - b Outline **two** examples of tertiary sector businesses AEC is likely to use. [4]
  - c Explain **two** reasons why it might be important for AEC to increase added value. [6]
  - d Explain **two** ways AEC could increase added value. Which way should it choose? Justify your answer. [8]
- 2 The government of Country Y owns and controls many businesses. 'The public sector always produces goods and services, such as electricity, more efficiently than privately owned businesses,' a government minister recently said. Other ministers disagree and want some businesses that are owned by the state to be sold to the private sector. The private sector businesses in Country Y produce 55% of total output of goods and services – mainly in services such as transport, tourism and finance.
  - a Define 'private sector'. [2]
  - b Outline **two** reasons why the government owns some businesses. [4]
  - c Explain **two** possible reasons why government ministers want some businesses to be sold to the private sector. [6]
  - d Do you agree with the government minister's view that: 'The public sector always produces goods and services more efficiently than privately owned businesses'? Justify your answer. [8]

### Revision checklist

In this chapter you have learned:

- ✓ the nature of business activity and the four factors of production
- ✓ the concept of adding value
- ✓ how added value can be increased
- ✓ the concept of opportunity cost
- ✓ the differences between primary, secondary and tertiary sectors
- ✓ the differences between the private and public sectors.

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