EDEXCEL INTERNATIONAL AS — WBS12

UNIT 2: Managing Business Activities

COMPLETE SPEC-ACCURATE REVISION BOOKLET

Rebuilt against the official Pearson Edexcel specification (Issue 1, 2017) — every bullet point covered

★ What's inside this booklet

SECTION A EXAM TECHNIQUE — READ THIS FIRST

WBS12 Paper Structure

The Unit 2 paper is 2 hours, 80 marks total, divided into three sections:

Section	Format
Section A	Short & extended-response questions based on Source 1 — 30 marks
Section B	Short & extended-response questions based on Source 2 — 30 marks
Section C	One 20-mark essay question based on one or more sources — 20 marks

➖ Mark Tariff Guide

- 2 marks — Define a term OR state one point with minimal development
- 4 marks — Two developed points, or one point fully applied to context
- 6 marks — Two analytical paragraphs with clear cause-effect chains, applied to the case
- 8 marks — Analysis both sides + evaluative judgement. Use data from the source material
- 10 marks — Full two-sided analysis + strong justified conclusion referencing the case context
- 20 marks — Intro → 3–4 analytical paragraphs (both sides) → justified conclusion. Reference context throughout

The PEEL Paragraph Formula

🧠 MEMORY TRICK: PEEL = Point, Evidence, Explain, Link

POINT: state your argument. EVIDENCE: use data/facts from the source. EXPLAIN: chain the cause-and-effect mechanism — use 'this means that', 'as a result', 'therefore'. LINK: connect back to the question. Every analytical paragraph needs all four elements.

Calculation Questions — Non-Negotiable Rules

⚠ Golden Rules — Every Calculation

- Write the FORMULA first, then substitute numbers — even if you think it's obvious
- Show EVERY line of working — method marks are awarded even if the final answer is wrong
- Label every figure with its unit: £, %, units, days, times — missing units costs marks
- After every calculation, INTERPRET: 'This means the business needs to sell X units before making any profit'
- If your answer looks wildly wrong, flag it but don't leave it blank — attempt earns more than nothing

Evaluation Framework — CDSTQ

🧠 MEMORY TRICK: CDSTQ = Conclusion, Depends, Short vs Long term, Type/size of business, Quantify

Use this to make sure your conclusions have depth. State what you conclude (C), what it depends on (D), whether the effect is different short-term vs long-term (S), whether it matters for the specific type/size of business in the case (T), and where possible quantify the impact (Q).

2.3.1 PLANNING A BUSINESS AND RAISING FINANCE

Spec ref: Spec: 2.3.1 — Planning, Internal Finance, External Finance, Forms of Business, Liability

1. Planning a Business

1a. What is a Business Plan?

Business Plan	A formal document outlining a business's objectives, strategies, market analysis, financial forecasts and operational plans. Used internally to guide decisions and externally to attract finance.

Contents of a Business Plan — ALL 7 Elements (Spec-required)

Element	What It Covers
1. Executive Summary	A brief overview of the whole plan — what the business is, its key objectives and financial highlights. Read first by investors.
2. The Business Opportunity	Description of the product/service, quantity to be produced, estimated selling price and the gap in the market being targeted.
3. Financial Forecasts	Cash flow forecast, sales forecast, projected profit & loss, and projected balance sheet. Shows viability.
4. Business & Its Objectives	Business name, address, legal structure (sole trader, Ltd etc.), mission, SMART objectives.
5. Personnel	Who will run the business, number of employees, their roles, skills and experience.
6. Finance	How much finance is needed, where it will come from (internal/external sources), and the repayment plan.
7. Premises & Equipment	Where the business will operate, what equipment is needed and how it will be financed (purchase vs lease).

Why Business Plans Matter

★ Relevance and Uses of a Business Plan

- Secures external finance — banks and investors require evidence of viability before lending/investing
- Forces the entrepreneur to think rigorously through every aspect of the business before launch
- Sets measurable benchmarks so actual performance can be compared against plan
- Reduces the risk of failure by identifying problems in advance
- Communicates the vision to employees, partners and stakeholders

⚖ Limitations of Business Plans

- Based on estimates and assumptions which may prove wrong — especially sales forecasts
- Plans become outdated quickly in fast-changing markets — require constant revision
- Writing a plan does not guarantee success — poor execution still leads to failure
- Small businesses may lack the expertise to construct a high-quality plan
- Can create false confidence if the plan is not based on rigorous research

2. Internal Finance

Spec ref: Spec 2.3.1.2 — Owner's capital, retained profit, sale of assets

Internal Finance	Money generated from within the business or its current owners — does not involve borrowing from external parties.

Source	Description, Advantages & Limitations
Owner's Capital / Personal Savings	Money invested by the owner from personal funds. Most common for start-ups and sole traders. No interest cost but owner bears all financial risk. Limited by personal wealth.
Retained Profit	Profit after tax that is reinvested back into the business rather than distributed to owners. Free of interest charges. Only available to profitable businesses. Reduces dividends to shareholders.
Sale of Assets	Selling assets no longer needed — old machinery, property, vehicles. One-off source of cash. Cannot be repeated for the same asset. May disrupt operations if core assets are sold.

★ Internal vs External Finance — Key Evaluation

- Internal finance is CHEAPER — no interest payments, no loss of ownership
- Internal finance is LIMITED — a business may not be profitable or have surplus assets
- Retained profit requires the business to have been trading profitably — not available to start-ups
- Sale of assets is a one-off — cannot be relied upon as a regular source
- Link to business type: sole traders rely heavily on personal savings; established PLCs use retained profit

3. External Finance

Spec ref: Spec 2.3.1.3 — Sources of finance; Methods of finance

3a. Sources of External Finance

External Finance	Finance raised from outside the business. Can come from a variety of sources depending on the size, legal structure and risk profile of the business.

Source	Description & Evaluation
Family and Friends	Informal lending or investment from personal contacts. Flexible repayment terms. Risk of damaging relationships if business fails. Often no formal agreement.
Banks	Formal loans and overdrafts with fixed interest rates and repayment schedules. Require business plan and credit history. Most common external source.
Peer-to-Peer (P2P) Funding	Online platforms match individual lenders with borrowers. Often lower interest rates than banks. Growing rapidly (e.g. Funding Circle). Requires credit check.
Business Angels	Wealthy individuals who invest equity in early-stage businesses in exchange for a stake. Also provide mentorship and contacts. Suitable for high-growth start-ups.
Crowdfunding	Raising small amounts from a large number of people via online platforms (e.g. Kickstarter, Seedrs). Can be reward-based, equity-based, or loan-based. Good PR and market validation. No single investor has control.
Other Businesses	Strategic investment, joint ventures or supply chain financing. Another business invests in exchange for a commercial relationship or equity stake.

3b. Methods of External Finance

Method	How It Works & Key Evaluation Points
Bank Loan	Fixed sum borrowed at agreed interest rate over a set period. Suitable for capital expenditure (machinery, premises). Does not dilute ownership. Requires regular repayments.
Share Capital	Selling equity stakes to shareholders. No repayment required but dilutes ownership and control. PLCs sell on stock market; Ltd companies sell privately.
Venture Capital	Finance from specialist firms investing in high-growth businesses in exchange for equity. Also provide expertise and networks. Seek high returns — may push for IPO or sale.
Overdraft	Short-term facility to spend more than available in the bank account. Very flexible. High interest rate. Repayable on demand. Best for short-term cash flow gaps.
Leasing	Using an asset (machinery, vehicle) by paying regular rentals rather than purchasing outright. Preserves cash. No ownership. Long-term cost exceeds purchase price. Asset can be upgraded regularly.
Trade Credit	Agreement to pay suppliers 30–90+ days after receiving goods. Effectively free short-term finance. Damages supplier relationships if overused. Most businesses get 30 days as standard.
Grants	Non-repayable funds from government or other bodies for qualifying purposes (e.g. enterprise zones, R&D). No interest, no equity given. Competitive and time-consuming to apply for. Often require matched funding.

➡ Finance — Exam Technique

- Always link finance choice to PURPOSE: long-term investment → loan/share capital; short-term gap → overdraft/trade credit
- Always link to BUSINESS TYPE: sole traders cannot issue shares; start-ups cannot use retained profit
- Consider COST: interest (loans/overdraft) vs equity dilution (shares/venture capital) vs free (grants/trade credit)
- Consider RISK: high gearing from excessive loans increases financial risk
- The spec specifically names peer-to-peer funding and crowdfunding — know these as distinct modern sources

4. Forms of Business

Spec ref: Spec 2.3.1.4 — Sole trader, partnership, Ltd, franchising, social enterprise, lifestyle businesses, online businesses, PLC and flotation

4a. Traditional Forms

Form	Key Features
Sole Trader	One owner. Unlimited liability. Simple to set up. All profits kept by owner. Full personal control. Cannot raise finance through shares. Examples: plumber, freelancer, local shop.
Partnership	2–20 partners (standard). Unlimited liability unless Limited Liability Partnership (LLP). Shared workload, skills, decision-making. Risk of disagreements. Dissolution if partner leaves. Examples: law firms, GP surgeries.
Private Limited Company (Ltd)	Separate legal entity. Limited liability for shareholders. Shares sold privately — not on stock market. More complex setup (Companies House). Owners are 'directors'. Examples: most SMEs.

4b. Other Business Forms (ALL Spec-Required)

Form	Key Features & Evaluation
Franchise	Franchisee pays for the right to operate under the franchisor's brand, using their systems and products. Lower risk than independent start-up — proven model. Ongoing royalty fees (typically 5–15% of revenue). Less autonomy. Examples: McDonald's, Subway, Kumon.
Social Enterprise	Business that trades commercially but whose primary purpose is social/environmental rather than profit maximisation. Profits reinvested into the social mission. Examples: The Big Issue, Divine Chocolate, BRAC. Access to grants not available to purely commercial businesses.
Lifestyle Business	Small business designed to provide the owner with a particular lifestyle rather than to maximise growth or profit. Owner prioritises flexibility, personal interest and work-life balance. Examples: small yoga studio, surf school, freelance photographer. Limited growth ambition by design.
Online Business	Business operating primarily or entirely through digital channels. Low overhead costs (no physical premises). Global reach from day one. Reliant on technology and logistics. Examples: Etsy sellers, SaaS businesses, e-commerce stores. Highly scalable.

4c. Growth to PLC — Stock Market Flotation

Public Limited Company (PLC)	A company that has issued shares to the public on a recognised stock exchange. Shares can be freely bought and sold. Minimum share capital: £50,000. Must publish detailed annual accounts. Examples: Apple, Tesla, Tesco, BP.

Process of Stock Market Flotation (IPO)

1. Business decides to 'float' — offers shares to the public for the first time (Initial Public Offering / IPO)
2. Investment bank appointed to price shares and manage the process
3. Prospectus published — detailed financial and business information for potential investors
4. Shares listed on the stock exchange (e.g. London Stock Exchange, NYSE)
5. Shareholders can buy and sell shares freely on the open market

Advantages	Disadvantages
Advantages of PLC Status	Disadvantages of PLC Status
Access to vast capital from public shareholders	Loss of control — hostile takeovers possible
Increased profile and brand credibility	Short-termism from pressure to deliver quarterly profits
Existing shareholders can exit by selling shares	Expensive and complex — legal, accounting, compliance costs
Can use shares as currency for acquisitions	Required to publish detailed accounts — competitors gain insight
Enhanced ability to attract talented management	Subject to stock market volatility — share price fluctuates

MEMORY TRICK: PLC vs Ltd: 'PLCs go PUBLIC, Ltds stay PRIVATE' — Public = on the stock market; Private = shares sold to selected individuals only.

PLC shares can be bought by anyone. Ltd shares require board approval to transfer. This is the fundamental distinction.

5. Liability

Spec ref: Spec 2.3.1.5 — Limited and unlimited liability; finance appropriate for each

Unlimited Liability	The owner is personally responsible for ALL debts of the business. If the business cannot pay its debts, the owner's personal assets (home, savings, car) can be seized. Applies to: sole traders and standard partnerships.

Limited Liability	The owner's financial responsibility is LIMITED to the amount they invested in the business. Personal assets are protected. Applies to: Ltd companies, PLCs, and Limited Liability Partnerships (LLPs).

Unlimited Liability	Limited Liability
Unlimited Liability	Limited Liability
Sole traders and standard partnerships	Ltd companies, PLCs, LLPs
Personal assets at risk if business fails	Only investment in the business is at risk
No formal separation between owner and business	Business is a separate legal entity from owners
Simpler legal structure — cheap to set up	More complex — must register with Companies House
May deter investment — full personal risk	Encourages investment — reduced personal risk

Finance Appropriate for Each

Business Type	Appropriate Finance Sources
Unlimited Liability Businesses	Personal savings (owner's capital), family & friends, bank loans (if credit-worthy), overdraft, trade credit, leasing. Cannot issue shares as they have no shareholders.
Limited Liability Businesses	All of the above PLUS share capital, venture capital, crowdfunding (equity). Can also access institutional investors and stock market (PLC only). Generally easier to raise larger amounts.

⚖ Liability — Why It Matters

- Limited liability makes it easier to attract investors — reduces risk of personal financial ruin
- This is why most growing businesses incorporate as Ltd at some point
- The trade-off: limited liability requires more administration and transparency
- Exam point: a sole trader who takes a bank loan has their personal home on the line — this is a significant risk

2.3.2 FINANCIAL PLANNING

Spec ref: Spec: 2.3.2 — Sales/Revenue/Costs, Sales Forecasting, Break-even, Cash Flow, Budgets

1. Sales, Revenue and Costs

Spec ref: Spec 2.3.2.1

1a. Key Calculations

Sales Revenue = Selling Price per Unit × Sales Volume

E.g. £15 × 2,000 units = £30,000. Revenue is NOT profit — costs must be deducted.

Total Variable Costs = Variable Cost per Unit × Output

Variable costs change directly with output — e.g. materials, direct labour on piece-rate.

Total Costs = Fixed Costs + Total Variable Costs

Fixed costs do NOT change with output (rent, insurance, management salaries).

Average Cost (Unit Cost) = Total Costs ÷ Total Output

As output rises, fixed costs are spread over more units — unit cost falls. This is economies of scale.

1b. Fixed vs Variable Costs

Fixed Costs	Variable Costs
Fixed Costs	Variable Costs
Do NOT change with output in the short run	Change directly with output
Rent, rates, insurance, management salaries, depreciation	Raw materials, packaging, direct labour (piecework), energy per unit
Must be paid even if output = 0	Zero if output = 0
Shown as horizontal line on break-even chart	Shown as upward-sloping line added to fixed costs

1c. Ways to Improve Sales Volume and Revenue

Method	How It Works & Limitation
Lower prices (penetration)	Increases volume — only improves revenue if demand is price elastic (PED > 1)
Increase marketing spend	Shifts demand curve right — higher volume at same price
New distribution channels	Reach more customers — e.g. going online, new geographic markets
Product development / improvement	Attracts new customers and retains existing ones
Improved customer service	Increases repeat purchase and word-of-mouth
Sales promotions (BOGOF, discounts)	Short-term volume boost — risk of training customers to wait for deals

2. Sales Forecasting

Spec ref: Spec 2.3.2.2 — Purpose, factors affecting forecasts, difficulties

Sales Forecast	A quantitative estimate of future sales volume or revenue over a specified time period, based on analysis of past data and market conditions.

2a. Purpose of Sales Forecasts

- Plan production capacity — how much to produce and when
- Determine staffing levels — how many workers are needed
- Manage cash flow — forecast when money will come in
- Set budgets — expenditure budgets are built on revenue forecasts
- Attract investors — demonstrates market knowledge and planning discipline

2b. Factors Affecting Sales Forecasts

Factor	How It Affects the Forecast
Consumer trends	Changes in fashion, demographics, lifestyle — e.g. growing health consciousness boosting protein food sales
Economic variables	GDP growth/recession, interest rates, inflation, unemployment — all affect consumer spending power and confidence
Actions of competitors	New competitor entry, competitor price cuts, competitor product launches — reduce demand for own products

2c. Difficulties of Sales Forecasting

⚠ Why Sales Forecasts Are Often Wrong

- Future is inherently uncertain — unexpected events (pandemics, recessions, new competitors) invalidate forecasts
- Consumer preferences change rapidly — especially in fashion, technology and food
- Seasonal variations are hard to predict precisely — an unusually cold summer wrecks a forecast for ice cream sales
- New businesses have no historical data to base forecasts on — rely entirely on market research estimates
- The further into the future the forecast, the less reliable it becomes
- Human bias — entrepreneurs may be over-optimistic (which is why banks challenge business plan forecasts)

3. Break-Even Analysis

Spec ref: Spec 2.3.2.3 — Contribution, break-even, margin of safety, charts, limitations

3a. Contribution

Contribution per Unit = Selling Price per Unit − Variable Cost per Unit

Contribution is what EACH UNIT sold contributes towards covering fixed costs and then making profit. It is NOT profit itself.

Total Contribution = Contribution per Unit × Units Sold

Once Total Contribution exceeds Total Fixed Costs, the business starts making profit.

🧠 MEMORY TRICK: Contribution = Selling Price MINUS Variable Cost (not minus ALL costs)

Students frequently subtract fixed costs too — wrong. Contribution only deducts variable costs. Fixed costs are covered by total contribution, not unit contribution.

3b. Break-Even Point

Break-Even Output = Fixed Costs ÷ Contribution per Unit

The exact number of units that must be sold to cover ALL costs. At break-even: Total Revenue = Total Costs. Profit = £0.

Example: Fixed costs = £60,000. Selling price = £25. Variable cost = £10. Contribution = £15. Break-even = £60,000 ÷ £15 = 4,000 units.

3c. Margin of Safety

Margin of Safety = Actual (or Forecast) Sales − Break-Even Output

How far sales can fall before the business makes a loss. Can also be expressed as a percentage: (Margin of Safety ÷ Actual Output) × 100.

Example: Forecast sales = 6,000 units. Break-even = 4,000 units. Margin of safety = 2,000 units (33.3%).

3d. Break-Even Chart — What to Know

Element	Description
Total Revenue line	Starts at origin (0,0). Gradient = selling price per unit.
Total Cost line	Starts on the Y-axis at the level of fixed costs. Gradient = variable cost per unit.
Fixed Cost line	Horizontal line at the level of fixed costs — does not change with output.
Break-Even Point (BEP)	Where Total Revenue and Total Cost lines intersect. Output on X-axis = break-even output.
Profit area	Triangle to the RIGHT of BEP where TR > TC.
Loss area	Triangle to the LEFT of BEP where TC > TR.
Margin of Safety	Horizontal gap between the actual/forecast output and the BEP — shown on X-axis.

3e. Limitations of Break-Even Analysis

⚠ Break-Even — Six Spec-Required Limitations

- Assumes ALL output is sold — in reality unsold stock may build up, especially in slow markets
- Assumes selling price is constant at all output levels — ignores bulk discounts needed to sell more
- Assumes variable costs are perfectly proportional — ignores economies of scale that reduce unit cost
- Assumes fixed costs are truly fixed — in practice they 'step up' at certain output levels
- Static model — does not account for market changes over time
- Only useful for single-product businesses — multi-product businesses cannot simply aggregate

4. Cash Flow

Spec ref: Spec 2.3.2.4 — Construction and interpretation of cash flow forecasts; uses and limitations

Cash Flow Forecast	A month-by-month prediction of all expected cash inflows and outflows, used to identify periods when the business may face a cash shortage and plan accordingly.

4a. Cash Flow Forecast Structure

Row	What It Represents
Opening Balance	Cash held at the START of the period (same as previous month's closing balance)
Total Cash Inflows	All cash coming IN: sales revenue received, loans received, asset sales, capital injected by owner
Total Cash Outflows	All cash going OUT: materials, wages, rent, loan repayments, tax, marketing
Net Cash Flow	Total Inflows MINUS Total Outflows (can be positive or negative)
Closing Balance	Opening Balance + Net Cash Flow = cash at END of period (= next month's opening balance)

Key formula:

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Closing Balance = Opening Balance + Net Cash Flow
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The closing balance rolls forward — it becomes the next period's opening balance.

4b. Uses of Cash Flow Forecasts

- Identify months where outflows exceed inflows — arrange overdraft or delay payments in advance
- Support bank loan or overdraft applications — demonstrates planning ability
- Monitor actual cash against forecast — identify problems early
- Make investment timing decisions — defer major purchases to high-inflow months

4c. Limitations of Cash Flow Forecasts

⚖ Why Cash Flow Forecasts Have Limits

- Based on estimates — sales and costs may differ significantly from forecasts

- Unexpected events (bad debt, supplier price rises, equipment failure) are not captured
- New businesses lack historical data — forecasts are essentially educated guesses
- Does not show profit — a business can have positive cash flow but be making a loss (e.g. by delaying payments to suppliers)
- Complexity increases with business size — multi-product, multi-currency businesses are very hard to forecast accurately

➖ Profit vs Cash — Examiners Test This Every Year

- A business can be PROFITABLE but have a CASH FLOW CRISIS — e.g. sells on credit (revenue recognised) but has not yet received payment
- A business can have POSITIVE CASH FLOW but be making a LOSS — e.g. receives a large loan
- This is the spec's explicit 'distinction between profit and cash' requirement — know it cold

5. Budgets

Spec ref: Spec 2.3.2.5 — Purposes, types (historical vs zero-based), variance analysis, difficulties

Budget	A quantified financial plan for a future period, setting out expected income, expenditure or both. Used to coordinate activity, control costs and measure performance.

5a. Purposes of Budgets

- Planning: forces managers to think ahead and allocate resources in advance
- Control: actual performance is compared against budget — variances highlight problems
- Coordination: ensures different departments' spending plans align with overall business targets
- Motivation: gives departments clear targets to work towards
- Authorisation: sets spending limits — managers cannot exceed budget without approval

5b. Types of Budget

Type	Description & Evaluation
Historical (Incremental) Budgets	Based on last year's actual figures, adjusted for expected changes. Easy and quick to prepare. Risk: perpetuates inefficiencies and outdated spending patterns. 'We always spent £X, so we budget £X+5%' — no challenge to existing spend.
Zero-Based Budgets (ZBB)	Every line of expenditure must be justified from scratch each year — starts from zero, not from last year's figures. Eliminates waste and challenges assumptions. Time-consuming and requires significant management effort. Best suited for organisations wanting to cut costs or restructure.

5c. Variance Analysis

Variance	The difference between the budgeted figure and the actual figure. Can be favourable (better than expected) or adverse (worse than expected).

Type	Meaning
Favourable Revenue Variance	Actual revenue > Budget — sold more than planned or at a higher price
Adverse Revenue Variance	Actual revenue < Budget — sold less than planned or at a lower price
Favourable Cost Variance	Actual costs < Budget — spent less than planned (more efficient)
Adverse Cost Variance	Actual costs > Budget — overspent (more expensive than planned)

Variance (Revenue) = Actual Revenue − Budgeted Revenue

Positive = Favourable. Negative = Adverse.

Variance (Costs) = Budgeted Costs − Actual Costs

Positive = Favourable (spent less). Negative = Adverse (spent more).

⚖ Variance Analysis — Evaluation Points

- Always investigate the ROOT CAUSE — 'adverse cost variance because raw material prices rose globally' is better than 'costs were too high'
- Variances can be LINKED: higher-than-forecast sales may cause higher-than-forecast variable costs (adverse cost, favourable revenue — this is acceptable)
- An adverse variance is not always a failure — if strategic spend (e.g. marketing) generates more revenue, it may be justified
- Budget reliability: if the original budget was poorly set, variances are meaningless — question the quality of the planning
- Distinguish controllable variances (management failure) from uncontrollable ones (external shocks like commodity price spikes)

5d. Difficulties of Budgeting

⚠ Why Budgeting Is Hard

- Future is uncertain — sales, costs and economic conditions change unpredictably
- Budget-setting can become political — departments fight for larger allocations
- Historical budgets perpetuate waste and inefficiency
- Rigid budgets reduce flexibility — managers may refuse beneficial spending that exceeds budget
- Small businesses may lack the data and expertise to set reliable budgets
- Variances may be caused by external factors beyond management control

2.3.3 MANAGING FINANCE

Spec ref: Spec: 2.3.3 — Profit, Liquidity, Business Failure

1. Profit

Spec ref: Spec 2.3.3.1 — Gross profit, operating profit, net profit; income statement; profitability ratios; ways to improve

1a. The Income Statement — Structure

Income Statement Line	What It Represents
Revenue (Turnover)	Total sales income = Selling Price × Quantity Sold
− Cost of Sales (COGS)	Direct costs of goods sold: raw materials, direct labour, direct overheads
= GROSS PROFIT	Revenue minus Cost of Sales
− Operating Expenses	Indirect overheads: rent, admin, marketing, R&D, depreciation
= OPERATING PROFIT	Gross Profit minus Operating Expenses — profit from core business before financing
− Interest (Finance Costs)	Interest paid on loans and overdrafts
= PROFIT BEFORE TAX	Operating Profit minus Finance Costs
− Tax (Corporation Tax)	Tax owed to the government on profits
= PROFIT FOR THE YEAR (Net Profit)	The 'bottom line' — what belongs to owners after all deductions

1b. Profit Calculations

Gross Profit = Revenue − Cost of Sales

Operating Profit = Gross Profit − Operating Expenses

Net Profit (Profit for the Year) = Operating Profit − Interest − Tax

1c. Profitability Ratios

Gross Profit Margin (GPM) (%) = (Gross Profit ÷ Revenue) × 100

Shows percentage of each £1 of revenue remaining after direct production costs. Higher = more efficient production. Compare over time and against industry benchmark.

Operating Profit Margin (OPM) (%) = (Operating Profit ÷ Revenue) × 100

Measures profit from core operations before interest and tax. Useful for comparing operational efficiency between businesses with different debt levels.

Net Profit Margin (NPM) (%) = (Net Profit ÷ Revenue) × 100

The 'bottom line' profitability ratio. Shows what percentage of revenue ultimately becomes profit after ALL costs. Rising GPM with falling NPM = overheads growing faster than gross profit.

1d. Ways to Improve Profitability

Strategy	How It Works
Increase Revenue	Higher selling price (if demand is inelastic), higher volume, new markets, new products
Reduce Cost of Sales	Negotiate better supplier prices, improve production efficiency, reduce waste, use cheaper materials without sacrificing quality
Reduce Operating Expenses	Cut overhead costs — renegotiate rent, reduce admin headcount, improve energy efficiency
Reduce Finance Costs	Repay debt, refinance at lower interest rates, reduce reliance on overdraft

★ Interpreting Profitability Ratios — Examiner Requirements

- Never just state the number — interpret it: 'A GPM of 40% means 40p of every £1 of revenue remains after direct costs'
- Compare to: previous year (trend), industry average, competitor — context makes the ratio meaningful
- Rising GPM with falling NPM signals overheads are growing too fast relative to gross profit
- Falling ratios are not always failure: aggressive growth investment may temporarily compress margins
- A business with high revenue but thin margins may be less financially healthy than a smaller one with fat margins

2. Liquidity

Spec ref: Spec 2.3.3.2 — Profit vs cash distinction; balance sheet; liquidity ratios; ways to improve; working capital

2a. The Critical Distinction: Profit vs Cash

Profit	Revenue minus ALL costs over a period — an accounting concept. A business can be profitable but still run out of cash.
Cash	Physical money available to the business right now — used to pay wages, suppliers, and bills. Without cash a business cannot survive even if it is profitable.

➡ Profit ≠ Cash — Most Common Exam Trap

- A business records profit when a SALE is made — but cash may not arrive for 30–90 days (credit terms)
- A profitable business can fail if it cannot pay wages or suppliers on time — this is a cash flow crisis
- Example: a business sells £100,000 of goods on credit but has £0 cash and wages due next week → crisis

- This is why cash flow management is as important as profitability — know both concepts distinctly

2b. Statement of Financial Position (Balance Sheet) — Key Structure

Section	What It Contains
Non-Current Assets (NCA)	Assets held for 1+ years: property, plant, equipment, intangible assets (brands, patents, goodwill)
Current Assets (CA)	Short-term assets converted to cash within 1 year: cash, inventory (stock), trade receivables (debtors)
Current Liabilities (CL)	Short-term debts due within 1 year: trade payables (creditors), overdrafts, short-term loans, tax due
Net Current Assets (Working Capital)	CA − CL = short-term financial health indicator. Positive = can pay short-term debts.
Non-Current Liabilities (NCL)	Long-term debts due in 1+ years: bank loans, mortgages, bonds
Net Assets	Total Assets − Total Liabilities = what the business is worth
Equity (Shareholders' Funds)	Share capital + Retained profit = equals Net Assets (the accounting equation balances)

2c. Liquidity Ratios

Current Ratio = Current Assets ÷ Current Liabilities

Ideal range: 1.5–2.0. Below 1.0 = cannot cover short-term debts (danger). Above 2.0 = possible inefficiency (too much cash/stock tied up). Retailers often run lower ratios due to high stock.

Acid Test Ratio = (Current Assets − Inventories) ÷ Current Liabilities

More conservative — strips out stock which may be slow to convert to cash. Ideal: at least 1.0. Below 0.5 = serious liquidity concern. Particularly important for manufacturers and retailers with large stock holdings.

2d. Ways to Improve Liquidity

Method	How It Works & Evaluation
Sell assets	Convert non-current assets into cash — e.g. sale-and-leaseback of property. Quick but one-off.
Negotiate extended supplier credit terms	Pay suppliers later (e.g. 60 days instead of 30) — keeps cash in the business longer. Risk: damages supplier relationships.
Factoring	Sell outstanding invoices (debtors) to a factoring company at a discount — receive cash immediately. Cost: the factor takes a fee (typically 2–5%). Useful for businesses with long debtor days.
Reduce inventory / JIT	Hold less stock — releases cash tied up in unsold goods. Requires reliable supply chain.
Improve debtor collection	Chase customers more aggressively, offer early payment discounts, tighten credit terms.
Cut costs	Reduce outflows to improve the net cash position.
Raise additional finance	Short-term overdraft, new loan, or equity injection from existing shareholders.

2e. Working Capital and Its Management

Working Capital	Current Assets minus Current Liabilities. The funds available to meet the day-to-day operational needs of the business. Positive working capital is essential for survival.

Working Capital = Current Assets − Current Liabilities

Also called 'net current assets'. If negative, the business cannot meet its short-term obligations from current resources — a serious warning sign.

Situation	Implication
Too little working capital	Cannot pay wages, suppliers or bills on time — risk of insolvency even if profitable
Too much working capital	Inefficient — cash and stock sitting idle that could be invested productively
Good working capital management	Optimising the cash conversion cycle: collect debtors fast, pay creditors slowly, minimise stock without risking stockouts

3. Business Failure

Spec ref: Spec 2.3.3.3 — Internal and external causes of business failure

Business Failure	When a business is unable to continue trading, typically because it cannot meet its financial obligations — most commonly because it runs out of cash.

3a. Internal Causes of Business Failure

Internal Cause	Explanation
Poor management of cash flow	Business fails to monitor inflows and outflows — runs out of cash to pay bills even when profitable. Most common cause of small business failure.
Overestimation of sales	Optimistic forecasts lead to overproduction, excess stock, and committed costs with insufficient revenue to cover them.
Overtrading	Growing too fast without adequate working capital to support the increase in activity — taking on orders that require cash outflows before revenue arrives.
Poor inventory control	Too much stock: cash tied up, storage costs, obsolescence risk. Too little stock: stockouts, lost sales, customer dissatisfaction.
Poor marketing	Failing to understand customer needs, targeting wrong segments, ineffective promotion — leads to falling demand.
Poor quality	Defective products lead to returns, complaints, reputational damage and loss of customers — increasing cost and reducing revenue simultaneously.

3b. External Causes of Business Failure

External Cause	Explanation
Market conditions	Declining demand for the product — changing consumer tastes, market saturation, demographic shifts.

External Cause	Explanation
Competition	New entrants, aggressive pricing by competitors, superior products from rivals eroding market share.
Economic factors	Recession reduces consumer spending; rising inflation increases input costs; low consumer confidence suppresses demand.
Exchange rates	Adverse currency movements increase import costs or reduce export competitiveness — squeezes margins.
Interest rates	Rising rates increase loan repayment costs — particularly damaging for highly geared businesses.
Government regulations	New compliance requirements add costs — environmental, employment, safety legislation.
Supplier problems	Key supplier failure, price increases, or quality problems disrupting production.
Natural phenomena	Earthquakes, floods, pandemics — can destroy premises, disrupt supply chains, or eliminate demand overnight.

⚖ Business Failure — Evaluation Points

- Most failures involve BOTH internal and external factors — e.g. a recession (external) exposes poor cash management (internal)
- Small businesses are more vulnerable to external shocks — less financial resilience, no buffer stock of working capital
- The most common cause of small business failure is cash flow problems — not unprofitability
- Many causes are PREDICTABLE: good planning and monitoring can mitigate them (contingency planning, cash flow forecasting)
- External causes are harder to prevent but can be mitigated: insurance, diversified markets, flexible costs

2.3.4 RESOURCE MANAGEMENT

Spec ref: Spec: 2.3.4 — Production/Productivity/Efficiency, Capacity, Inventory Control, Quality Management

1. Production, Productivity and Efficiency

Spec ref: Spec 2.3.4.1 — Production methods, productivity, efficiency, labour vs capital-intensive, lead times

1a. Methods of Production

Method	Key Features & Examples
Job Production	One unique item at a time, made to individual customer specification. Highly skilled workforce required. Very high unit cost. High quality and flexibility. Examples: bespoke suits, bridges, custom wedding cakes, Rolls-Royce cars.
Batch Production	Groups of identical items made together. Machinery and labour retooled between batches. Moderate unit cost. Some flexibility. Work-in-progress stock between stages. Examples: bakeries, clothing manufacturers, pharmaceuticals.
Flow (Mass) Production	Continuous, uninterrupted production of standardised products on an assembly line. Highly capital-intensive. Very low unit cost (economies of scale). Little flexibility. Worker boredom risk. Examples: cars (Toyota), canned food, electronics (mass-market).
Cell Production	Workers in small teams ('cells') complete a whole sub-assembly. Combines efficiency of flow with motivation benefits of teamwork. More flexible than pure flow. Examples: some car assembly plants, electronics manufacturing.

MEMORY TRICK: Production Methods: 'Just Because Flow Comes Naturally' = Job, Batch, Flow, Cell — from most customised to most standardised.

The more standardised, the lower the unit cost but the less flexibility. The more customised, the higher the price that can be charged but the smaller the potential market.

1b. Productivity

Productivity	Output per unit of input per time period. Usually measured as output per worker. Higher productivity = more output from the same resources = lower unit costs = competitive advantage.

`Labour Productivity = Total Output ÷ Number of Workers`

E.g. 12,000 units ÷ 60 workers = 200 units per worker. Compare over time or against industry.

Factors Influencing Productivity

Factor	How It Affects Productivity
Motivation	Better motivated workers produce more per hour — links to Herzberg (job enrichment, recognition) and Maslow (esteem)
Training	Skilled workers are more productive — fewer errors, faster working, better problem-solving
Technology / Capital	Machinery and automation increase output per worker — capital-intensive production
Management quality	Clear direction, efficient scheduling, removal of obstacles to work

Factor	How It Affects Productivity
Working conditions	Good environment, ergonomic setup, reliable equipment reduce downtime

Ways to Improve Productivity

- Capital investment in automation and technology
- Training and development programmes
- Motivation improvements — performance pay, job enrichment, empowerment
- Lean production — eliminate waste and inefficiency
- Better management systems and processes

Link Between Productivity and Competitiveness

★ Why Productivity Matters Strategically

- Higher productivity → lower unit costs → lower prices possible OR higher profit margins
- Lower unit costs enable either cost leadership (compete on price) or higher margins on same price
- UK businesses historically lag behind Germany, France and the USA in labour productivity — this is a national competitiveness issue
- Exam tip: always connect productivity improvements to UNIT COST reductions and then to competitive advantage

1c. Efficiency

Efficiency	Production at minimum average (unit) cost — getting the maximum output from given inputs with minimal waste.

Unit Cost (Average Cost) = Total Cost ÷ Total Output

Efficiency = driving unit cost as low as possible. As output rises, fixed costs spread over more units — unit cost falls.

Ways to Improve Efficiency

- Increase output to spread fixed costs over more units (economies of scale)
- Lean production — eliminate non-value-adding activities
- Invest in more productive capital equipment
- Improve workforce skills and reduce errors
- Better supply chain management — reduce input costs

1d. Labour-Intensive vs Capital-Intensive Production

Labour-Intensive	Capital-Intensive
Labour-Intensive Production	Capital-Intensive Production
Relies primarily on workers rather than machinery	Relies primarily on machinery, technology and automation
Higher variable costs (wages)	Higher fixed costs (capital investment)
More flexible — workers can multi-task	Less flexible but far higher volume capability
Suitable for job/batch production, services	Suitable for flow/mass production, manufacturing

Labour-Intensive	Capital-Intensive
Examples: hairdressing, consulting, farming (in some regions)	Examples: car manufacturing, oil refining, automated warehouses

1e. Competitive Advantage from Short Lead Times

Product Lead Time	The time between placing an order (or starting production) and the customer receiving the finished product.

★ Why Short Lead Times Create Competitive Advantage

- Faster delivery gives customers what they want sooner — improves satisfaction and loyalty
- Reduces stock holding — less capital tied up in work-in-progress
- Allows the business to respond to orders rather than producing to forecast (reducing overproduction risk)
- In fast-moving markets (fashion, technology) speed-to-market is critical — first mover advantage
- Links to lean production and JIT — reducing waste in the production process shortens lead times

2. Capacity Utilisation

Spec ref: Spec 2.3.4.2

Capacity	The maximum output a business is capable of producing in a given time period with its current resources.

Capacity Utilisation (%) = (Actual Output ÷ Maximum Possible Output) × 100

Optimal range: 85–90%. Too low = rising unit costs. Too high = strain and quality risk.

Situation	Problems It Creates
Under-utilisation (< ~85%)	Fixed costs spread over fewer units → higher unit costs → less competitive. Workers and machinery idle. May signal declining demand or excess capacity from over-investment.
Over-utilisation (near 100%)	Strain on equipment and workforce. Quality may suffer. Unable to meet unexpected demand spikes. Equipment downtime cannot be scheduled — risk of breakdown.

Ways to Improve Capacity Utilisation (Under-Utilisation)

- Find new customers or enter new markets to increase demand
- Reduce prices (penetration) to stimulate demand
- Subcontract spare capacity to other businesses
- Rationalise (close plants, make redundancies) — reduces maximum capacity to match actual output

Ways to Manage Over-Utilisation

- Capital investment — purchase additional machinery or expand premises
- Subcontract production to third parties
- Extend working hours — overtime, additional shifts
- Multi-skilling — flexible workforce can be redeployed where needed
- Raise prices — reduces demand to a manageable level while improving margins

3. Inventory (Stock) Control

Spec ref: Spec 2.3.4.3 — Inventory control diagram, buffer stock, poor inventory control, JIT, waste minimisation, lean production

3a. Inventory Control Diagram — Key Terms

Term	Definition
Maximum Stock Level	The most stock the business will hold at any time — set to limit holding costs (storage, insurance, obsolescence)
Minimum Stock Level (Buffer Stock)	The safety stock held to protect against unexpected demand or supply delays — never fall below this
Reorder Level	The stock level at which a new order is automatically placed — must be above buffer to allow for lead time
Reorder Quantity	The amount ordered each time — set to minimise total of ordering costs + holding costs
Lead Time	The time gap between placing an order and receiving delivery — determines how far above buffer the reorder level must be set

3b. Implications of Poor Inventory Control

Problem	Consequences
Too much stock (overstocking)	Cash tied up in unsold goods; high holding costs (warehouse, insurance, staff); risk of obsolescence or spoilage; working capital reduced
Too little stock (understocking / stockout)	Production halts; orders cannot be fulfilled; customer dissatisfaction and lost sales; emergency purchasing at premium prices

3c. Just-in-Time (JIT) Inventory

Just-in-Time (JIT)	A lean production technique where materials and components are ordered and delivered exactly when needed for production — no buffer stock is held. Pioneered by Toyota.

⚖ JIT — Full Evaluation (Spec-Required)

- BENEFITS: eliminates stock holding costs (no warehouse needed); improves cash flow (no cash tied up in stock); reduces waste; forces suppliers to be reliable and high quality
- RISKS: any supply disruption halts production immediately — shown dramatically by COVID-19 semiconductor shortage
- REQUIREMENTS: extremely reliable suppliers; accurate demand forecasting; strong supplier relationships; fast, flexible supply chain
- NOT SUITABLE for: businesses with unpredictable demand; businesses with unreliable supply chains; businesses that cannot afford production stoppages

- Key insight: JIT transfers inventory risk FROM the manufacturer TO its suppliers — suppliers must hold more stock

3d. Waste Minimisation and Lean Production

Lean Production	A philosophy of eliminating all forms of waste (activities that use resources but add no value for the customer) to reduce costs and improve efficiency. Originated at Toyota (Toyota Production System).

MEMORY TRICK: The 7 Wastes — TIMWOOD: Transport, Inventory, Motion, Waiting, Overproduction, Over-processing, Defects

Any business activity falling into one of these categories wastes resources without adding customer value. Lean production targets each.

★ Competitive Advantage from Lean Production

- Lower unit costs through waste elimination → ability to undercut competitors on price (cost leadership)
- Faster throughput times → shorter lead times → better customer service
- Higher quality through defect elimination → reduced returns and customer complaints
- More motivated workforce if lean includes empowerment (Kaizen, quality circles)
- Improved working capital position — less cash tied up in stock and work-in-progress

4. Quality Management

Spec ref: Spec 2.3.4.4 — Quality control, assurance, circles; TQM; Kaizen; competitive advantage from quality

Quality	Fitness for purpose — a product or service that consistently meets or exceeds customer expectations. Quality is relative to the expectations set by the price point and the marketing.

Approach	Description & Evaluation
Quality Control (QC)	Inspection and testing of finished products AFTER production to identify and reject defects. Traditional reactive approach. Advantages: simple to implement. Disadvantages: defective items already produced (wasted resources); inspection is costly; does not prevent defects, only catches them.
Quality Assurance (QA)	Building quality checks INTO the production process at every stage — proactive prevention of defects rather than detection. Advantages: reduces waste by catching problems early; every worker is responsible for quality at their stage. Disadvantages: more training required; higher upfront cost to implement.
Quality Circles	Small groups of workers (6–10) from the same work area who voluntarily meet regularly to identify, investigate and solve quality and production problems. Links to empowerment (Herzberg) and teamwork (Maslow). Advantages: uses shop-floor knowledge; motivates workers. Disadvantages: management must act on suggestions or engagement falls.
Total Quality Management (TQM)	A whole-organisation philosophy and culture: everyone at every level is responsible for quality at every stage. Zero defects is the target. Continuous improvement (Kaizen). Customer focus is paramount. Advantages: systematic elimination of waste and defects; cultural shift to quality-first. Disadvantages: requires complete culture change; slow to implement; can fail if not fully committed from top to bottom.

Approach	Description & Evaluation
Kaizen (Continuous Improvement)	Japanese concept of making small, incremental improvements continuously — from all workers at all levels. No change is too small. Advantages: empowers workers, accumulates to significant improvements over time, low cost per change. Disadvantages: requires genuine worker engagement; slow pace may be insufficient in fast-changing markets.

★ Competitive Advantage from Quality Management

- Higher quality → fewer defects → lower cost of rework and returns → better margins
- Higher quality → stronger reputation → brand loyalty → ability to charge premium prices (reduced price elasticity)
- TQM and Kaizen align with Herzberg's motivators (responsibility, achievement, recognition) — dual benefit
- ISO 9001 certification demonstrates quality management to customers and partners — useful in B2B markets
- Quality failure is very costly to reverse — reputational damage (e.g. Samsung Galaxy Note 7 battery fires)

2.3.5 EXTERNAL INFLUENCES

Spec ref: Spec: 2.3.5 — Economic Influences, Legislation, Competitive Environment

1. Economic Influences

Spec ref: Spec 2.3.5.1 — Inflation, exchange rates, interest rates, taxation/government spending, business cycle

1a. Inflation

Inflation	A sustained rise in the general price level of goods and services, measured by the Consumer Price Index (CPI). Erodes purchasing power of money.

Effect	Mechanism for Business
Rising wages pressure	Workers demand higher pay to maintain real income → increases labour costs → squeezes profit margins
Rising input costs	Raw materials, energy, components become more expensive → cost of sales rises → GPM falls unless prices raised
Reduced consumer spending	Higher prices reduce real purchasing power → demand falls, especially for discretionary/luxury goods
Pricing difficulties	Hard to plan prices and commit to long-term contracts when costs are rising unpredictably
Interest rate response	Central banks raise interest rates to control inflation → increases borrowing costs for businesses

1b. Exchange Rates

Exchange Rate	The price of one currency in terms of another — e.g. £1 = $1.25. Changes in exchange rates affect the cost of imports and the price competitiveness of exports.

Exchange Rate Change	Effect on Business
Strong £ (Appreciation — £ buys more foreign currency)	IMPORTS cheaper (raw material costs fall, good for importers). EXPORTS more expensive in foreign markets (bad for exporters — demand falls). UK tourism more expensive for foreign visitors.
Weak £ (Depreciation — £ buys less foreign currency)	IMPORTS more expensive (raw material costs rise, inflation risk). EXPORTS cheaper overseas (more competitive, demand rises, good for UK exporters). UK tourism cheaper for foreign visitors.

MEMORY TRICK: SPICED: Strong Pound → Imports Cheap, Exports Dear

If the pound strengthens, foreign goods become cheaper to import (good for import-heavy businesses) but UK exports become more expensive (bad for exporters).

1c. Interest Rates

Interest Rate	The cost of borrowing money, set by the central bank (e.g. Bank of England base rate). Changes ripple through to mortgage rates, business loan rates and savings rates.

Change	Effect on Business (Mechanism)
Higher interest rates → businesses	More expensive to borrow → deters investment; higher loan repayments → reduced profit; highly geared businesses most vulnerable
Higher interest rates → consumers	Higher mortgage repayments → less disposable income → reduced consumer spending on non-essentials
Higher interest rates → exchange rates	Higher rates attract foreign investment → demand for £ rises → £ appreciates → exports become more expensive
Lower interest rates → businesses	Cheaper borrowing → encourages investment and expansion; reduces loan repayment burden; boosts consumer spending

1d. Taxation and Government Spending

Government Action	Effect on Business
Corporation tax increase	Reduces net profit retained by the business → less for investment or dividends → may shift investment to lower-tax countries
Income tax increase	Reduces consumer disposable income → lower demand for goods and services → particularly affects consumer goods businesses
VAT increase	Raises effective price to consumers → reduces demand unless business absorbs the cost → especially affects price-elastic goods
Government spending increase	Boosts aggregate demand → more business activity → benefits particularly infrastructure, construction, healthcare, education sectors
Subsidies	Government payments to businesses → lowers production costs → improves competitiveness → e.g. renewable energy subsidies
Business rates / tariffs	Additional costs on business premises or imported goods → increases costs → reduces competitiveness

1e. The Business Cycle

Business Cycle	The recurring pattern of economic expansion and contraction in an economy: Boom → Recession → Slump/Trough → Recovery → Boom.

Stage	Characteristics & Business Implications
Boom	High GDP growth, low unemployment, high consumer confidence, rising prices. Businesses expand, hire, invest. Risk of overtrading and inflationary wage pressure.
Recession	Two+ consecutive quarters of negative GDP growth. Unemployment rises, consumer spending falls,

Stage	Characteristics & Business Implications
	business investment contracts. Demand for luxury/discretionary goods falls most sharply.
Slump / Trough	GDP at lowest point. High unemployment, very low confidence. Many businesses fail. Opportunity for surviving businesses to acquire assets cheaply.
Recovery	GDP begins to grow. Employment and confidence improve. Businesses restart investment. Early movers gain competitive advantage.

⚖ Economic Influences — Evaluation Points

- Not all businesses are equally affected: recession hits luxury goods hard but benefits value retailers (Aldi, Lidl)
- Interest rate rises hit highly geared businesses hardest — low-debt businesses are more resilient
- A weak £ helps exporters but hurts importers — the NET effect depends on the business's import/export balance
- Businesses can PREPARE for economic changes: flexible cost structures, currency hedging, diversified markets
- Government policy changes are not always predictable — uncertainty itself damages business investment

2. Legislation

Spec ref: Spec 2.3.5.2 — Consumer protection, employee protection, environmental protection, competition policy, health & safety, intellectual property

2a. Consumer Protection

Law / Regulation	What It Requires from Business
Sale of Goods / Consumer Rights Act	Products must be of satisfactory quality, fit for purpose, and as described. Consumers entitled to repair, replacement or refund. Businesses must handle complaints and returns.
Consumer Protection from Unfair Trading	Bans misleading advertising, false pricing, and aggressive sales tactics. Businesses must not manipulate consumer decision-making.
Distance Selling Regulations	Consumers buying online or by phone have a 14-day cooling-off period with right to return. Major implication for e-commerce businesses.
Data Protection (GDPR)	Businesses must handle personal customer data lawfully, transparently and securely. Major fines for breaches. Affects all businesses holding customer data.

2b. Employee Protection

Law	Effect on Business
National Minimum Wage / Living Wage	Sets a legal floor on wages. Increases labour costs for businesses employing low-wage workers. Improves worker living standards.
Working Time Regulations	Maximum 48-hour working week (with opt-out option). Minimum paid holiday entitlement. Affects shift patterns, overtime, and staffing costs.

Law	Effect on Business
Equality Act	Prohibits discrimination on grounds of age, gender, race, disability, religion, sexual orientation. Affects recruitment, pay, promotion and dismissal processes.
Employment Rights Act	Minimum notice periods, protection from unfair dismissal, redundancy rights, maternity/paternity leave. Increases cost and complexity of workforce management.
Health & Safety at Work Act	Employers must provide a safe working environment. Risk assessments, protective equipment, staff training. Non-compliance → fines, prosecution, and reputational damage.

2c. Environmental Protection

Law	Effect on Business
Environmental Protection Act	Controls pollution of air, water and land. Businesses must manage waste responsibly and limit harmful emissions.
Climate Change Act / Carbon Targets	Businesses must reduce greenhouse gas emissions — drives investment in renewable energy and greener processes. Carbon taxes on high-emission activities.
Packaging Regulations	Producers responsible for recycling/recovery of packaging waste — adds cost.

2d. Competition Policy

Law / Body	Effect on Business
Competition and Markets Authority (CMA)	Investigates mergers that would create monopoly power. Can block deals, require asset disposals. Investigates anti-competitive practices.
Anti-Trust / Cartels	Price-fixing, market-sharing and bid-rigging are illegal. Businesses cannot collude to restrict competition.
Abuse of Dominant Position	A business with a dominant market share cannot use that position to crush competitors unfairly (e.g. predatory pricing to force rivals out).

2e. Intellectual Property Rights

Type	What It Protects & How
Patents	Grants inventor exclusive rights to produce/sell an invention for 20 years. Prevents competitors copying innovation. Must be applied for. Encourages R&D investment.
Copyright	Automatic protection of original creative works (writing, music, art, software) for the creator's lifetime + 70 years in most jurisdictions. No registration needed.
Trademarks	Registered distinctive signs (logos, brand names, slogans) that identify a business's products. Prevents competitors using similar marks. Can be renewed indefinitely.

★ Legislation — How to Evaluate in the Exam

- Legislation INCREASES COSTS: compliance, legal advice, record-keeping, training — especially for small businesses
- Legislation can PROTECT businesses too: patents prevent rivals copying innovation; competition law prevents large rivals crushing you
- TRADE-OFF: legislation increases certainty and consumer trust → may increase overall market size

- International businesses face DIFFERENT legislation in different countries — a compliance challenge in global operations
- Distinguish between the COST of compliance and the RISK of non-compliance (fines, reputational damage, prosecution)

3. The Competitive Environment

Spec ref: Spec 2.3.5.3 — Effects of competition (numbers, size, behaviour); ways for small businesses to compete

3a. Effects of Competition on Business

Competitive Factor	Effect on the Business
Number of competitors	More competitors → more choice for consumers → greater price pressure → thinner margins. Fewer competitors → more pricing power → better margins.
Size of competitors	Large rivals have economies of scale, larger marketing budgets, and more resources → can undercut on price or outspend on advertising → existential threat for small businesses.
Behaviour of competitors	Price wars, promotional campaigns, product launches, distribution expansion — all directly affect demand for your products and may require a strategic response.

3b. Ways for Small Businesses to Compete

★ How Small Businesses Survive Against Large Competitors

- NICHE FOCUS: target a specific, under-served segment that large businesses ignore — specialise rather than generalise
- PERSONALISATION: offer customised, personal service that large businesses cannot replicate at scale
- LOCAL KNOWLEDGE: stronger community relationships, faster local decision-making, understanding of local preferences
- FLEXIBILITY: quicker to adapt to changes in the market — less bureaucracy, shorter decision chains
- QUALITY OVER PRICE: compete on quality and uniqueness rather than trying to match large firms on cost
- INNOVATION: small businesses can be more entrepreneurial — first-mover advantage in niches
- ONLINE PRESENCE: e-commerce and social media marketing level the playing field — small businesses can reach global audiences cheaply
- COLLABORATION: working with other small businesses (e.g. shared logistics, joint purchasing) to gain scale benefits

⚖ Competitive Environment — Exam Evaluation

- Increasing competition is generally bad for margins — forces businesses to innovate or cut costs
- But competition also drives quality improvement and lower prices — benefits consumers
- A business with a strong USP or brand is more protected from competition than an undifferentiated one

- Digital disruption has intensified competition in almost every sector — new entrants (online businesses) face much lower barriers
- Porter's Five Forces framework maps the competitive environment systematically — mention it if asked about competitive pressures

SECTION 7 PRACTICE EXAM QUESTIONS

Short Answer Questions (2–4 Marks)

Define the term 'limited liability'. [2 marks marks]

How to answer: Give the precise definition — 'owner's financial responsibility limited to amount invested; personal assets protected'. Do not just say 'they are not liable for all debts' — be specific.

Identify and explain two internal causes of business failure. [4 marks marks]

How to answer: Name each cause + explain the mechanism (how it leads to failure). E.g. 'poor cash flow management — the business may run out of cash to pay suppliers and wages even if it is profitable, as profit and cash are different concepts.'

State two differences between a sole trader and a private limited company. [4 marks marks]

How to answer: Pick differences that are easy to explain: liability (unlimited vs limited), ability to raise finance (no shares vs can issue shares), legal structure (no separate entity vs separate legal entity).

Calculate the break-even output for a business with fixed costs of £45,000, a selling price of £30, and a variable cost per unit of £12. [3 marks marks]

How to answer: Step 1: Contribution = £30 − £12 = £18. Step 2: Break-even = £45,000 ÷ £18 = 2,500 units. Show both steps and label.

Application & Analysis Questions (6–8 Marks)

Analyse two ways in which a rise in interest rates could affect a clothing retailer that has a large bank loan. [6 marks marks]

How to answer: PEEL ×2. Point 1: Higher loan repayments → less profit after interest → reduced retained profit available for reinvestment. Point 2: Higher consumer mortgage costs → less disposable income → reduced consumer spending on clothing → falling sales revenue. Apply both points directly to the clothing retailer context throughout.

Analyse the likely impact of introducing zero-based budgeting on a large public sector organisation. [6 marks marks]

How to answer: Benefit: eliminates entrenched wasteful spending — every penny must be justified from scratch (apply to public sector where historical budgets perpetuate inefficiency). Challenge: enormously time-consuming; requires skilled financial management; may cause internal conflict as departments compete for resources.

Analyse two external causes of business failure that could affect a small UK restaurant. [8 marks marks]

How to answer: Pick 2 relevant external causes. E.g. (1) Economic recession — consumers cut discretionary spending on eating out first → revenue falls sharply → fixed costs (rent, wages) remain → cash flow crisis. (2) Rising interest rates → higher mortgage costs for consumers → less disposable income

→ plus higher loan repayments if restaurant has borrowed for refurbishment. Apply both to the restaurant context with full PEEL structure.

Evaluation Questions (10–20 Marks)

To what extent does the introduction of new employment legislation always damage business performance? [10 marks marks]

How to answer: FOR (it does damage): increases costs (higher wages, more admin, training compliance); reduces flexibility (harder to dismiss, zero-hours restrictions). AGAINST (it doesn't always): motivated, protected workforce is more productive (Herzberg); compliance improves reputation — ethical consumers prefer ethical employers; reduces staff turnover → lower recruitment costs. CONCLUSION: impact depends on the SIZE of the business (larger businesses absorb costs more easily), the NATURE of the legislation, and whether the business has been well-managed before (good businesses already treat workers fairly).

Evaluate the view that Just-in-Time stock management is always the most effective approach to inventory control for a manufacturing business. [20 marks marks]

How to answer: FOR JIT: eliminates holding costs; improves cash flow; reduces waste; forces quality into the supply chain. AGAINST / ALTERNATIVES: supply chain disruption risk (COVID proved devastating); requires perfect supplier reliability (not always possible); buffer stock provides resilience for unpredictable demand; JIT may be less suitable for seasonal businesses or those with long lead times. CONCLUSION: JIT is highly effective in stable, predictable, well-established supply chains (e.g. Toyota in Japan) — but the 'always' is wrong. A hybrid approach (very low buffer stock + strong supplier relationships + contingency plan) may be more resilient. Depends on the industry, supply chain reliability, and the cost of a production stoppage.

To what extent is a strong brand the most important factor in helping a small business compete with large competitors? [20 marks marks]

How to answer: FOR: brand builds loyalty, justifies premium price, reduces price competition, creates emotional connection. AGAINST / other factors: quality and innovation may matter more in B2B markets; personal service is a key advantage small businesses have; niche focus allows avoidance of direct competition; online presence can level the playing field; price competitiveness matters in price-elastic markets. CONCLUSION: brand is important but 'most important' is too strong — its importance depends on the market (B2C vs B2B), the product type (emotional vs functional), and what the business is already doing well. A combination of factors creates sustainable competitive advantage.

SECTION 8 FORMULA REFERENCE SHEET & SPEC CHECKLIST

Complete Formula Reference — Memorise Every One

Financial Planning

$$\text{Sales Revenue} = \text{Selling Price} \times \text{Sales Volume}$$

$$\text{Total Cost} = \text{Fixed Costs} + \text{Total Variable Costs}$$

$$\text{Average (Unit) Cost} = \text{Total Cost} \div \text{Output}$$

$$\text{Contribution per Unit} = \text{Selling Price} - \text{Variable Cost per Unit}$$

$$\text{Total Contribution} = \text{Contribution per Unit} \times \text{Units Sold}$$

$$\text{Break-Even Output} = \text{Fixed Costs} \div \text{Contribution per Unit}$$

$$\text{Margin of Safety} = \text{Actual Output} - \text{Break-Even Output}$$

$$\text{Net Cash Flow} = \text{Total Cash Inflows} - \text{Total Cash Outflows}$$

$$\text{Closing Balance} = \text{Opening Balance} + \text{Net Cash Flow}$$

$$\text{Variance (Revenue)} = \text{Actual Revenue} - \text{Budgeted Revenue}$$

Positive = Favourable

$$\text{Variance (Costs)} = \text{Budgeted Costs} - \text{Actual Costs}$$

Positive = Favourable

Managing Finance — Profitability

$$\text{Gross Profit} = \text{Revenue} - \text{Cost of Sales}$$

$$\text{Operating Profit} = \text{Gross Profit} - \text{Operating Expenses}$$

$$\text{Net Profit} = \text{Operating Profit} - \text{Interest} - \text{Tax}$$

```
Gross Profit Margin (%) = (Gross Profit ÷ Revenue) × 100
```

```
Operating Profit Margin (%) = (Operating Profit ÷ Revenue) × 100
```

```
Net Profit Margin (%) = (Net Profit ÷ Revenue) × 100
```

Managing Finance — Liquidity

```
Current Ratio = Current Assets ÷ Current Liabilities
```
Target: 1.5–2.0

```
Acid Test Ratio = (Current Assets − Inventories) ÷ Current Liabilities
```
Target: 1.0+

```
Working Capital = Current Assets − Current Liabilities
```
Must be positive

Resource Management

```
Labour Productivity = Total Output ÷ Number of Workers
```
Higher = more efficient

```
Capacity Utilisation (%) = (Actual Output ÷ Maximum Output) × 100
```
Target: ~85–90%

Key Mnemonics — Final Review

🧠 **MEMORY TRICK: Business Failure Internal Causes: 'CAMPOO' = Cash flow, Aims (overestimating sales), Marketing, Production quality, Overtrading, Over-inventory**

Every internal cause maps to a management failure. Contrast with external causes which are largely outside management's control.

🧠 **MEMORY TRICK: Exchange rates: SPICED = Strong Pound → Imports Cheap, Exports Dear**

Depreciation is the opposite: imports expensive, exports cheaper overseas.

🧠 **MEMORY TRICK: Production Methods risk order: 'Just Because Flow Can vary' = Job (highest cost/unit), Batch, Flow (lowest cost/unit), Cell**

Cost per unit falls as you move from job toward flow production.

MEMORY TRICK: 7 Wastes TIMWOOD: Transport, Inventory, Motion, Waiting, Overproduction, Over-processing, Defects

Any of these wastes resources without adding value the customer is willing to pay for.

MEMORY TRICK: Forms of business SPFOL: Sole trader, Partnership, Franchise, Online, Lifestyle (+ Ltd, PLC, Social enterprise)

Cover all 8 forms the spec names. Exam questions often ask about a specific form — know each one's characteristics.

Complete Spec Checklist — WBS12

Every line in this table maps to an official spec bullet point. Use it to self-test.

Covered	Spec Ref	Topic / Requirement
✗ NO	YES	2.3.1.1
✗ NO	YES	2.3.1.1
✗ NO	YES	2.3.1.2
✗ NO	YES	2.3.1.3
✗ NO	YES	2.3.1.3
✗ NO	YES	2.3.1.4
✗ NO	YES	2.3.1.4
✗ NO	YES	2.3.1.4
✗ NO	YES	2.3.1.5
✗ NO	YES	2.3.1.5
✗ NO	YES	2.3.2.1
✗ NO	YES	2.3.2.1
✗ NO	YES	2.3.2.2
✗ NO	YES	2.3.2.2
✗ NO	YES	2.3.2.2
✗ NO	YES	2.3.2.3
✗ NO	YES	2.3.2.3
✗ NO	YES	2.3.2.3
✗ NO	YES	2.3.2.3
✗ NO	YES	2.3.2.3
✗ NO	YES	2.3.2.4
✗ NO	YES	2.3.2.4
✗ NO	YES	2.3.2.5
✗ NO	YES	2.3.2.5
✗ NO	YES	2.3.2.5
✗ NO	YES	2.3.2.5
✗ NO	YES	2.3.3.1

Covered	Spec Ref	Topic / Requirement
✗ NO	YES	2.3.3.1
✗ NO	YES	2.3.3.1
✗ NO	YES	2.3.3.1
✗ NO	YES	2.3.3.2
✗ NO	YES	2.3.3.2
✗ NO	YES	2.3.3.2
✗ NO	YES	2.3.3.2
✗ NO	YES	2.3.3.2
✗ NO	YES	2.3.3.3
✗ NO	YES	2.3.3.3
✗ NO	YES	2.3.4.1
✗ NO	YES	2.3.4.1
✗ NO	YES	2.3.4.1
✗ NO	YES	2.3.4.1
✗ NO	YES	2.3.4.1
✗ NO	YES	2.3.4.2
✗ NO	YES	2.3.4.2
✗ NO	YES	2.3.4.2
✗ NO	YES	2.3.4.3
✗ NO	YES	2.3.4.3
✗ NO	YES	2.3.4.3
✗ NO	YES	2.3.4.3
✗ NO	YES	2.3.4.3
✗ NO	YES	2.3.4.4
✗ NO	YES	2.3.4.4
✗ NO	YES	2.3.4.4
✗ NO	YES	2.3.4.4
✗ NO	YES	2.3.5.1
✗ NO	YES	2.3.5.1
✗ NO	YES	2.3.5.1
✗ NO	YES	2.3.5.1
✗ NO	YES	2.3.5.1
✗ NO	YES	2.3.5.2
✗ NO	YES	2.3.5.2
✗ NO	YES	2.3.5.2
✗ NO	YES	2.3.5.2
✗ NO	YES	2.3.5.2
✗ NO	YES	2.3.5.2
✗ NO	YES	2.3.5.3
✗ NO	YES	2.3.5.3

100% of WBS12 spec bullet points covered in this booklet.

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