Revision Guide to A2 Level Business Studies

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Using this book

The A2 units use ideas from the AS course. These are not themselves explained again in detail in the A2 course, so it is important that you are really familiar with what you learnt during the AS course before you start to revise for A2. The following are particularly important:

Unit 1	Unit 2
Markets	Product life cycle
Opportunity cost and trade-offs	Boston matrix
Gross and net profit margins	Marketing mix
Marketing, market research	Market share
Market orientation	Cash flow
Pricing strategies	Working capital
Market positioning	Labour turnover
Market mapping	Mass and niche marketing
Competition	Branding
Competitive advantage	Contribution and break even analysis
Costs of production	Lean management
Pressure groups	Contingency planning
Stakeholders	Labour and capital intensive

Preparing for questions that require evaluation

- **Evaluation** means making a judgement about something. It may entail looking at the advantages and disadvantages or making a choice between alternatives. Good evaluation will also involve reaching a balanced conclusion.
- **Evaluation** does not have to be complex or difficult. It is usually the evaluation marks that separate the good candidates from the rest.

More emphasis is placed on evaluation at A2 level. The examiners will be looking for awareness that there are rarely any clear cut answers. In the real business world there are always differing points of view, alternative courses of action and conflicts of interest. You will need to consider these so that you can draw a balanced conclusion.

Use of examples

Your responses at A2 will gain better marks if you back up your arguments with examples. These can be taken from the evidence, the case study or your own wider reading. This guide also contains many useful examples.

Exam hints

- Do spend time reading the evidence and questions **BEFORE** you start to write.
- Work on approximately a mark a minute for your timing.
- Look for the command words like 'assess' and 'evaluate', and try to do just that, comparing different policies or plans and giving reasons why one may be a better course of action than the alternative.
- Don't write too much on the earlier (easier?) questions, move on and come back if there is time later.
- Don't rewrite the evidence in your answer, but do refer to it wherever it is relevant.

For much more on exam hints, go to www.anformeresources.com/examhints.html

Section 3.3.1

Chapter 1

Why does a business seek international markets?

Product or market conditions that may prompt a business to trade internationally

The world changes rapidly. Between 1950 and 2008, world wide, incomes and output grew at an average of 4% per year but trade, exports and imports, grew on average at 6%. Much, much more of what we produce and consume is now either exported or imported. A significant reason for this is that it has become easier to trade internationally.

In the past, many countries have tried to restrict trade, because governments feared that foreign competition might reduce demand for their own domestic products. So they put **tariffs** (import duties) and other restrictions on trade, so as to make imports dearer and discourage people from buying them. Then governments began to realise that other countries' trade restrictions were discouraging sales of their own exports.

Trading conditions

Over a long period, trade negotiations between governments led to these restrictions being much reduced. Some countries banded together in **trade blocs** like the EU. World-wide, long and detailed trade negotiations led to much easier trading conditions. This gave businesses everywhere a chance to develop their products for international markets and expand output. This process is known as **trade liberalisation**.

Tariffs are taxes on imported goods. They make the price higher and sales will generally be lower.

Trade liberalisation refers to the process of reducing barriers to trade so that economies can move gradually closer to free trade, which would mean that there are no trade barriers at all.

Trade blocs are groups of countries where barriers to trade are reduced or eliminated between member states.

Business responded

Why did businesses react so vigorously to the opportunities that trade liberalisation gave them?

There are many reasons why a business might want to start trading internationally. These include both factors that 'push' businesses out of domestic markets and factors that 'pull' them towards international ones. Often it is a combination of both. Most businesses want to expand and increase profitability. Moving into international markets is often the best way to do this.

Push factors

- Saturated domestic market
- Fierce competition in domestic market
- Competition from imports
- The product is in the mature or decline stage of product life cycle

Pull factors

- Potential for increased sales and profits
- Economies of scale
- Risk spreading
- Global sourcing
- Increasing trade liberalisation
- Expanding trade blocs

Push factors

Market saturation

For many businesses the first stimulus to start marketing abroad comes when it becomes steadily more difficult to increase sales in the domestic market. There will be few new customers left to target with their products or services. Sales will come either from existing customers replacing old or worn out products, or by attracting customers away from a rival's product. This situation is called **market saturation**.

> **Market saturation** occurs when it becomes impossible to expand sales further in that particular market. If the product is a durable good, e.g. a washing machine, it may still be possible to sell replacement machines.

Competition

Fierce competition from both local and foreign firms

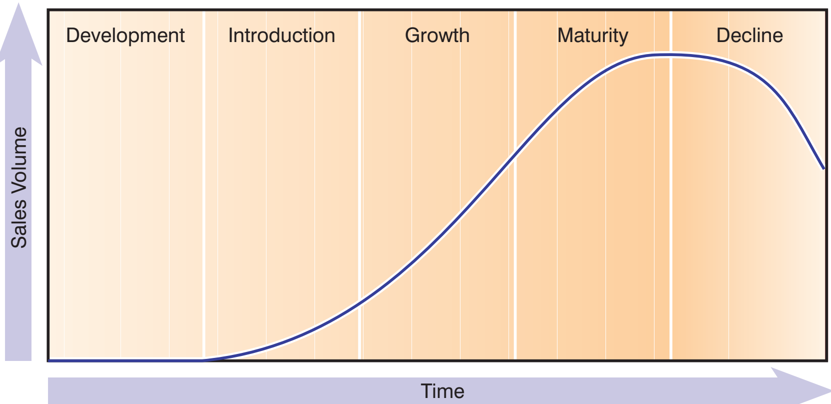
Competition can be fearsome, coming from both domestic suppliers and imports.

- In a saturated market, businesses compete vigorously to increase sales at the expense of rivals. Competition may be based on price or non-price factors.
- Competing businesses will be watching each other all the time, looking for ways to differentiate their products and get a larger market share. Innovative product design, reliability, reputation and clever marketing will be constantly stiffening the competition. Providing value for money will be a key factor.
- This can be an expensive process as it may require constant innovation and/or intensive marketing to increase market share.
- Imported products will often be able to compete on price. Foreign suppliers may have lower labour costs (e.g. in clothing manufacturing). For some products, this will give them a potentially strong competitive advantage.
- International markets can be a welcome addition to the domestic market, as they contain many potential new customers; the scope for expansion and increased profits can be enormous.

Often it is a combination of push and pull factors which cause firms to start trading internationally.

Product life cycle

The product life cycle helps to explain how businesses might respond to market saturation.



The **product life cycle** refers to the phases which many products go through between their first introduction to the market and the eventual decline in sales that may lead to production ceasing. These phases include development, introduction to the market, growth, maturity (during which sales are fairly constant) and decline.

Extension strategies

- A saturated market is one that is in the maturity stage of the cycle. Sales eventually reach a plateau and cannot be increased significantly.
- The usual solution for a business in this situation is to develop an extension strategy to prolong the maturity stage by bringing out a new or improved version.
- The next stage is decline, when no matter what the business does, sales and profits begin to fall.
- Moving into new international markets and exporting can be seen as an extension strategy.
- Equally, in a foreign market, the product can be placed earlier in the cycle, perhaps into the introduction or growth stages.

Example

This has happened in the cigarette industry. In the UK consumption is in the decline stage; public awareness of the health dangers has led to falling numbers of smokers. Cigarette companies are now targeting consumers in emerging economies where demand is growing. (Not everyone will approve of this strategy.)

An **extension strategy** is aimed at extending the life of a product either by making small changes in it, finding new uses for it, or finding new markets. More detail can be found in the AS Business Studies Revision Guide, pages 55-6.

Pull factors

Emerging economies

Potential for increased sales and profits

Access to new markets in **emerging economies** creates huge potential for increased sales and profits and major growth opportunities for many businesses. The profit motive is often paramount, especially for large businesses, i.e. those public companies that are answerable to a significant body of shareholders. There is a strong attraction to expanding into new markets to satisfy this motive.

Emerging economies are characterised by rapid economic growth. They have seen big increases in manufacturing output and standards of living are rising. Some would still be described as poor countries (e.g. India) but others (e.g. Mexico) are well on the way to becoming developed countries with modern economies. The group includes many smaller countries like Chile and Thailand.

Competitive advantage

Economies of scale

- Trading internationally will usually mean that the size of the business will increase.
- This means a greater chance of achieving economies of scale (a reduction in average cost brought about by increasing the scale of production).
- Increasing economies of scale can lead to a competitive advantage: lower costs may make lower prices possible and open up mass markets.
- Sometimes economies of scale are so significant that the most efficient level of output is greater than the level of demand for the product in any but the largest economies.

Risks

Risk spreading

- Diversified markets reduce risk: if sales fall in one market, they may still rise or remain stable in another. This is an economy of scale which can be achieved by selling a range of products or a single product in a range of different markets. Trading internationally gives a business greater stability: a problem or downturn in one country can be compensated by growth in another.
- The wider the risk is spread, the safer the business.

Global sourcing

- Global sourcing is a term used to describe the practice of finding goods and services from the global market.
- It may mean just buying from cheaper sources abroad, or setting up production facilities abroad to take advantage of lower costs of production. This is called **offshoring**.
- These savings include low cost labour (which may be skilled or unskilled), low cost raw materials and other economic factors such as tax breaks and low tariffs on trade.

Offshoring

- Offshoring applies to services as well as to manufactures.

Offshoring means locating production in a foreign country. The objective is to exploit cost savings, most often lower wage rates.

Examples

Dyson manufactures in Malaysia. Nike products all come from manufacturers in East Asia. JCB has set up its own factories in India. Peugeot-Citroen, Ford, Volkswagen and Hyundai all manufacture cars in Slovakia, which has a population of 5 million and a tiny market for cars but plenty of cheap skilled labour. If you go to virtualemployee.com you can see how business-to-business (B2B) services might be obtained cheaply.

Increasing trade liberalisation

It becomes easier to trade when trade barriers are dismantled, and more firms are attracted to doing business internationally. There have been several factors contributing to this on-going process.

- In the period just after the end of the World War II, there was a general feeling of the need to bind nations together to prevent further catastrophe. Many people believed that we could set up international institutions that would encourage international co-operation and reduce aggression.

International institutions

- In the late 1940s, the **IMF** and the **World Bank** were set up.
- Permanent arrangements were made to facilitate trade negotiation – at first via GATT, which later turned into the **WTO**.
- Discussions began that would ultimately lead to the formation of the EU.

The **International Monetary Fund** (**IMF**), co-ordinates the international monetary system. It tries to keep the system stable, and provide adequate finance for world trade to continue without interruption.

The **World Bank** (proper name International Bank for Reconstruction and Development) lends to developing countries in order to fund projects which will help them to raise incomes and make their economies more efficient.

The **WTO**, World Trade Organisation, started out as GATT, the General Agreement on Tariffs and Trade. It supervises world trading arrangements and trade negotiations and helps to resolve disputes between governments.

These bodies have all contributed to the increase in international trade. Trade negotiations take a very long time to reach agreement. But, over many decades, trade barriers have been dramatically reduced by participating governments as more and more countries joined the WTO. 153 countries are already members. China joined in 2001. Russia cleared all the hurdles needed to join formally in 2011.

WATCH OUT!

Do not confuse trade liberalisation with free trade. Trade liberalisation is an on-going process that may or may not have free trade as an ultimate aim.

Expanding trade blocs

A trade bloc can be a **free trade area**, a loose alliance of countries that want free trade between themselves. Or it can be a tightly integrated **common market**. This will have harmonised business regulations so that there is a 'level playing field', with all businesses competing on equal terms.

Free trade areas

- The creation and growth of trade blocs has made it much easier to access member countries' markets without hindrance.
- They encourage specialisation and open up new markets.
- The best known free trade area is NAFTA (North American Free Trade Area).
- The best known common market is the EU (European Union).
- Other trade blocs include ASEAN (the Association of South East Asian Nations) and MERCOSUR (the Southern Common Market, which includes Argentina, Brazil and some neighbouring countries).

Free trade areas are groups of countries that trade completely freely with each other, with no trade barriers, but each member country retains its own independent trade policies in relation to the rest of the world.

Common markets

Common markets have completely free trade internally and a single unified trade policy covering all member countries' trade with the rest of the world. But besides free movement of goods and services, there is also free movement of people and capital. Individuals in all member countries can work in any other member country. Businesses based within the common market can invest in any member country.

Trade blocs

Trade blocs all encourage and increase trade amongst the member states; this is called **trade creation**. After the UK joined the EU, its exports to other member countries increased greatly. Trade blocs also create **trade diversion**. This is because member countries may end up trading more with each other and less with the outside world. This can be a barrier to true worldwide free trade.

Trade creation occurs when there is an increase in the total amount of goods and services traded because of reduced trade restrictions within a trading bloc.

Trade diversion occurs when a trading bloc reduces imports from non-member countries, enabling businesses within member countries to increase sales inside the trading bloc.

Benefits and constraints of trading within a trading bloc e.g. EU

Benefits

- Access to other markets without exports being penalised
- Manufacturers can import from bloc members without tariffs
- Possibility of economies of scale
- Spreading of risk
- A trading bloc creates a larger market which attracts **foreign direct investment** (**FDI**) from outside
- Greater competition within trade bloc can increase efficiency within firms

Constraints

- No protection for domestic industries from other bloc member's exports
- Increased competition for domestic producers
- A common external tariff in a common market can increase costs of raw materials/supplies from outside
- Reaching agreement with member states can be difficult and time consuming
- New rules and regulations may not suit all businesses

Why international trade is increasing

Trade barriers

Reduction of trade barriers

The past 60 years or so have seen an exceptional growth in international trade. Exports grew on average by 6% annually. Total trade in 2000 was 22-times the level of 1950.

WTO

The WTO (World Trade Organisation – formed 1995)

- The WTO is the successor to the General Agreement on Tariffs and Trade (GATT).
- Its stated aim is to oversee and regulate the international trading environment.
- It has over 150 members, accounting for over 97% of world trade. Around 30 others are negotiating membership.
- The main objective is to help trade flow smoothly, promote free trade and encourage economic growth by reducing trade barriers.
- It does this by acting as a forum for trade negotiations, administering trade agreements and trying to resolve trade disputes.
- It also helps developing nations with technical matters and training programmes.

WTO

What it does not do

- It is not a global policeman.
- It cannot 'force' countries to co-operate.

The WTO has its critics

- The WTO has been accused of favouring the richer countries at the expense of the developing ones.
- Some doubt that free trade and liberalisation are the best solutions for developing nations.

FDI

Foreign direct investment (FDI)

- As trade barriers are reduced, the flow of FDI increases as businesses set up factories or other kinds of production or distribution facilities in other countries.
- Much FDI flows from one **developed country** to another but increasingly, FDI is flowing into **developing countries**.
- It may be associated with offshoring of production in countries with lower input costs, or it may be directed towards production for foreign markets.

Foreign direct investment (**FDI**) occurs when businesses or governments invest in other countries. They may build factories or offices, develop mines or create their own marketing and distribution systems. There is a good deal of FDI between the UK and the USA but increasingly, emerging economies are both receiving and extending their own FDI.

Developed countries include most of Europe, Japan, the USA, Canada and Australia. All have high incomes. Through capital investment, they have acquired sophisticated production facilities. Some countries that were until recently placed in the developing country category are now considered to be developed. These include Singapore and South Korea. Others are not far behind them.

Developing countries have relatively low standards of living, compared to the developed countries. They may have small manufacturing sectors and the majority of the population engaged in agriculture. They have limited infrastructure and levels of investment are often low. Many of the worst off have been damaged by wars.

Political change

Breakdown of old political orders

- The collapse of the Soviet Empire and communist rule in Eastern Europe in 1989 opened these areas up to international business.
- Russia itself has become one of the **BRICs** and has huge reserves of minerals and energy supplies.
- China has moved a long way away from its previous hard-line communist and isolationist stance. Both Chinese people and foreigners can set up their own businesses in China, provided they have the approval of the Communist Party. Chinese suppliers actively seek customers for their exports.

BRICs

BRIC stands for Brazil, Russia, India and China. These are the world's four largest fast-growing economies. The term is sometimes used to refer to all fast-growing economies. South Africa thinks of itself as the fifth of the BRICS. All are often described as emerging economies.

Transport

Improvements in communication and transportation links with countries

- As it gets easier and cheaper to communicate with other countries and to travel to them, so the amount of trade increases.
- Revolutions in transport systems, in particular containerisation, have reduced transport costs. Air freight has become cheap enough to be used for high value-low bulk products.
- Cheap air travel and telecoms have made international communication with markets and suppliers easy and cheap. Forging international relationships is often almost as easy as with local ones.

Responding to the opportunities

There are various ways of expanding markets, depending on the nature of the product and the relevant markets:

- Many countries that used to be seen as developing economies are now categorised as emerging economies. This group includes the BRICS but also many others. All of them have a growing middle class, some of whom are becoming very rich and keen to buy luxury products. They will appreciate branded goods identical to those sold in the exporting country. Simply by setting up distribution systems in the big Chinese cities, Burberry has increased sales dramatically.
- In all emerging economies and all developing countries there are large numbers of poorer people whose incomes are growing slowly. They are creating new markets, but not necessarily for the very same products that sell in the developed world.
- The key factor in creating new markets is to understand the needs of potential buyers. Just exporting existing products with little or no awareness of local needs may fail to open up a potential mass market.
- **Backward innovation** deliberately simplifies existing products to develop a lower cost version. This is a strategy that responds to local needs and requirements and can achieve a mass market by appealing to customers with low or middle incomes.
- Businesses that are facing saturated markets can expand rapidly by using backward innovation to create completely new markets.

Backward innovation involves developing low cost products that will appeal to people with relatively low incomes. Frequently they will have just the most basic functions of sophisticated manufactured products, and may be similar to the early versions of products that are now sold with many more features in developed economies.

Examples

Mobile phones provide a good example of this. In the UK nearly everyone who wants a mobile has one. There is a constant battle by manufacturers to produce a better, 'smarter' phone than their rivals'. By comparison, expanding into markets in the emerging economies, where many people have yet to buy their first phone, is an attractive proposition. But these people cannot afford smartphones: they are looking for something that is much cheaper.

Microsoft is developing new phone app services for the most basic mobiles. These allow users to access web sites such as Twitter and Facebook. They are designed for markets in India and South Africa, where there is strong demand for low-cost apps that can access cloud computing platforms.

Innovation

Selling product innovations in multiple markets

- It makes sense to sell product innovations in a variety of different markets in order to maximise sales and profits.
- Innovation can be an expensive process; selling in more markets helps to recoup the investment more quickly.
- Average costs are reduced as the fixed costs of innovation are spread over greater output.