Revision Guide to A Level Business Year 2

Themes 3 and 4 of Edexcel's Business

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Using this book

This revision guide covers Themes 3 and 4 of Edexcel's Business course. Much of the content builds on work done in Themes 1 and 2. Do not rely on this book alone. First, there are many pointers showing where you should revise earlier work, in order to get a full understanding of the Year 2 work.

Each theme has a glossary, but the words in the earlier ones mostly do not get repeated. Each theme glossary includes only the terminology that is relevant and new for that theme.

Revision guides are good for checking knowledge but do not help much with the important skills of application, analysis and evaluation. So you must practice these skills by tackling exam questions that force you to think through the problems that businesses face, the possible solutions that may work for them and the range of possible outcomes. Seek advice from teachers about practice questions.

Paper 3 in particular requires a synoptic approach. The questions expect you to draw on detail from a range of topics and themes. When working on case studies, you will usually need to include aspects of several topic areas, maybe production, marketing and the international scene, showing how many different activities contribute to meeting specific business objectives.

This gets easier towards the end of the course. In this book you will find many cross-references to particular pages where something relevant is to be found. You will also have become familiar with all aspects of the course. So you can see how different parts of the subject link up in different contexts.

In some places, this revision guide goes a little further than the textbooks, to show the connections between different theories and events that figure in the course. Revision guides can refer to ideas from all over the course – because you have at least some understanding of all topics covered. Think about how the many components of the subject fit together.

A word about evaluation. It means *making a judgment about something.* It might involve looking at advantages and disadvantages, or making a choice between alternative strategies and discussing the underlying reasons for each. If you are comparing two possible strategies, you could say:

Strategy X would be likely to solve (this problem, whatever it is) but there could be disadvantages such as…

Or, *strategy Y might have the advantage of… but might cause complications because…*

Always back up your argument with examples drawn from the evidence, or a case study you recall, a recent news item or an example from this book.

Good evaluation requires a balanced conclusion. Many of the issues you encounter are controversial, involving conflicts of interest and different points of view. Clear-cut answers may be rare. In the real world of business, situations can change quite rapidly; business decisions have to keep pace with reality.

What about Brexit. This creates a great deal of uncertainty. The 2017 exams were written around the beginning of 2016, with the referendum still six months off. However you will still be able to pick up marks wherever recent events are relevant to the question, for example on the effects of exchange rate changes. The 2018 exams may have questions with case studies relating to Brexit, requiring analysis that does not figure in this book. This course covers trade blocs and global business and it should help you to understand current events and write better answers.

You are living in interesting times. We hope that your understanding of the subject will carry you through the years of uncertainty that are to come and help you to deal with whatever challenges you face.

3.1

Theme 3: Business decisions and strategy

Chapter 1

Business objectives and strategy

3.1.1 Corporate objectives

Development of corporate objectives from mission statements/corporate aims

Aims

Aims are very broad long term ideas as to how the business should develop. They may be stated or unstated and can be rather vague. A company may simply aim to be profitable with a successful and long term future. Or it may have more specific aims – for example relating to quality or reputation, or expansion overseas.

A **mission statement** is a more inspirational and motivating version of a corporate aim. It should be short, relevant and specific and convey to everyone the value of the brand and why it exists. It can influence customer perceptions of the product as well as encouraging employees to focus on issues such as costs or quality.

Mission statements

Example

Nike may aim to be the leading sportswear company in the world but its mission statement says:

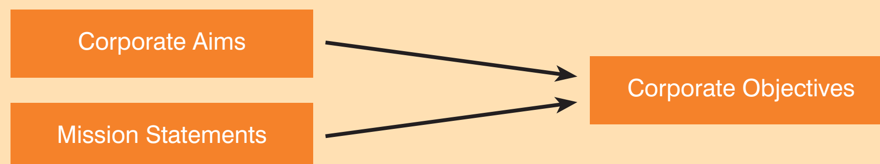
To bring inspiration and innovation to every athlete in the world.

Similarly, Coca-Cola may aim to sell more fizzy drinks than anyone else but its mission statement says:

To refresh the world – in mind, body and spirit.

To inspire moments of optimism – through our brands and actions.

To create value and make a difference everywhere we engage.



Corporate objectives

- **Corporate objectives** are derived from the aims and mission statement of a business.
- They are general objectives that refer to the business as a whole.
- In order to get these grand aims and missions to work, businesses have to identify corporate objectives that are practical and effective. They might, for example, relate to survival, profitability, market standing or business responsibility.

Corporate objectives are specific, realistic and measurable goals which an organisation plans to achieve within a given period of time. These goals will influence its internal strategic decisions.

- From corporate objectives, more specific and detailed objectives can be worked out; these may relate to individual departments or to functional objectives.
- If a corporate objective is to increase profits this in turn may set an objective for the sales department of increasing turnover. The production department may have to fulfil an objective of cutting costs.
- Then within the sales department, specific objectives might be set for each individual team, relating to that team's specific responsibilities.
- Within each team, individuals might be given different objectives to help achieve the team objective.
- The objective becomes more detailed as it passes down from corporate to individual level.
- Objectives are used to form strategies.

Profitability vs. ethics

Example
Up to 2008, many banks made profitability their prime corporate objective. (Within the banks, many employees had a good bonus as a personal objective.) Later it became clear that some banks had pursued profitability as an objective partly by lending to people and businesses that might find it hard to pay them back, partly also by selling financial products that were inappropriate for their customers' needs. The consequences of these profit objectives became clear during the financial crisis that began in 2008. Even after that, some banks prioritised high pay for senior bankers over dividends for shareholders. Eventually, in 2012-13, after much discussion, some banks began to work out new objectives. Barclays promised an ethical approach to banking; the chief executive presented a vision of the bank "doing well financially and behaving well… reconciling the interests of customers, shareholders and society."

A hierarchy of objectives

Once aims and objectives have been defined, it is possible for the business to devise suitable strategies that will actually make it possible to reach their objectives successfully. This will require careful consideration, clear evidence and a comparison of possible alternatives. For example, strategic decisions need to reflect the findings of market research and the production technologies available. The strategy needs to cover obtaining the necessary finance, recruiting suitable skilled staff and organising production.

Strategy

A **strategy** is a plan of action that is designed to fulfil an objective. A strategy cannot be formed until the objective has been defined.

Don't forget, corporate objectives should be SMART:

- **S**mart
- **M**easurable
- **A**chievable
- **R**elevant
- **T**ime-bound

Critical appraisal of mission statements and corporate aims

- Mission statements can say a great deal about the culture of the business.
- They may include statements of ethical principles and practice.
- They may be designed to attract the customer or to energise the employee.
- **But** – are they worthwhile?

Motivating or just PR?

Yes	No
• Can give staff a sense of common purpose and direction. • Can increase motivation. • Can help stakeholders to understand the central aim of the business. • Can inform the consumer.	• Can just be a PR exercise, designed to create a good public image. • Usually impossible to prove. • May be rather vague. • It is impossible to sum up what a business is all about in a few sentences.

Some businesses have used mission statements as a way to counteract unfavourable publicity. A business which emphasises shareholder value, believing that the interests of shareholders are paramount, may have sought to make profits in ways which are inconsistent with corporate social responsibility. They may try to improve their images with a mission statement that distracts us from their most important objective – making a profit. Look again at the mission statements for Nike and Coca-Cola, two companies that are very keen to make a profit. Would you guess this from reading them?

Try this
Find two examples of mission statements and use the table above and your knowledge of the company to help you evaluate their likely usefulness.

3.1.2 Theories of corporate strategy

Development of corporate strategy

Strategic decision making involves making plans for the future, exploring potential objectives for both the medium and the long term. Strategies must be achievable. So it is important to investigate the costs as well as the potential gains. A range of alternatives will usually be considered. In this way the business can select the most promising strategy within the framework of its overall aims and objectives and the constraints under which it is operating. The outcome will be different for each individual business.

Developing an overall corporate strategy means planning and implementing a wide range of specific strategies that meet corporate objectives. Strategies can include…

Corporate strategies

- Entering or leaving certain markets.
- Introducing or phasing out some products or services.
- Taking on a partner for a strategic alliance.
- Forming other relationships with strategic business partners.
- Acquiring or divesting companies, brands, products or assets.
- Arranging financing.
- Developing management teams.

There is no one standard method of developing a corporate strategy. Much will depend on the current circumstances of the business and the requirements of the corporate objectives. Developing a corporate strategy usually takes some time and is likely to be modified or changed as circumstances develop. Both Ansoff's Matrix and Porter's strategic matrix can help here.

Ansoff's Matrix

Igor Ansoff was a business theorist who approached strategic planning by defining goals in line with the resources the business has and the competitive conditions it faces. Ansoff's Matrix is a decision making model that can be used to help businesses to analyse their strategic options for achieving growth, focusing on potential risks and rewards.

Degree of risk

Figure 1: Ansoff's Matrix

- Ansoff's Matrix is used to analyse both a business's products and its markets.
- Each square in the grid represents a combination of product and market.
- It also reflects the degree of risk involved for the business. Introducing a new product into a new or unfamiliar market is the most risky strategy.
- Ansoff's matrix provides a way of looking at the relative risks of **organic growth**.

Market penetration means selling more of the same products to the same customers. It is the least risky strategy as the business understands both the product and the market. This strategy will involve changes in the marketing mix. The business might try to increase brand loyalty, or encourage customers to buy the product more often. It will tend to focus on market share.

Product development means selling new products to existing, well-known customers. The risk is higher as the products are new but the customers are familiar. This strategy is particularly useful where there is strong competition and the business needs to keep its products clearly differentiated from those of competitors.

Market development means selling the same products but to new customers. The risk occurs because the business is not familiar with the new markets, but they do know how their product sells in existing markets. They can look for new geographical areas in which the product can succeed, or for new uses for the existing product or for new market segments.

Diversifying

Diversification is the most risky strategy as new products are being sold to new customers. The business is entering new and unfamiliar territory in terms of both products and customers.

Organic growth occurs when an individual business increases its sales revenue by expanding its facilities and producing and selling more. This type of expansion from within is likely to be quite slow but steady and secure. (In contrast inorganic growth involves merging with or taking over another business – see Chapter 2, pages 17-18.)

- Ansoff has been criticised for oversimplifying the options available. For example it is possible to diversify by offering a new product in a familiar market.
- Diversification may involve a very risky strategy at the start, but in the long run it may spread risks. Customers may melt away in one country or market but increase in number in another market.

- A business wanting to grow internationally will, by definition, be looking at new markets so that 'Market Development' or 'Diversification' are the only options.
- Some businesses deliberately design a new or modified product to meet the specific needs of a new market. This is diversification but extensive market research can reduce the risk of bringing an inappropriate product to a new market.

Reducing risks

Example
BP realised some time ago that it needed to diversify. There were fears that oil might run out; that was solved by drilling deeper and going to more difficult places – like the Arctic. Then BP took seriously the possibility that petrol consumption might fall because of concern about the environment. That encouraged BP to look at alternatives such as biofuels. In 2008 they started refining sugar cane to make ethanol in Brazil. Capacity there is expanding. Other sources of income have come from the Wild Bean Cafés, attached to BP petrol stations. BP bought Aral, a widely respected chain of petrol stations in Germany which also sells fast food. Notice the different ways of diversifying, both inorganic and organic, in both product ranges and new markets.

Although Ansoff's Matrix can be criticised for its simplicity, it still provides a useful way to analyse market opportunities. It is important to remember that business growth is not just about selling more products. Enhanced reputation can allow the business to raise prices and make bigger profits. Capital investment projects or other ways of improving the organisation of the business can help to cut costs and prices and increase sales. All three of these strategies could be directed towards market penetration, but the business might prefer to maintain existing prices and collect the benefits in the form of higher profits. Success can take many forms.

Try this
How could Starbucks have used Ansoff's Matrix when considering whether to open outlets outside the USA?

Porter's strategic matrix

"Competitive strategy is about being different. It means deliberately choosing a different set of activities to deliver a unique mix of value." Michael Porter

Sustainable competitive advantage

- Porter said that if a business wants above-average profitability it has to develop a sustainable competitive advantage.
- There are two basic types of competitive advantage a firm can achieve: low cost or significant differentiation.
- Both of these can be looked at in a broad context (mass market) or a narrow one (niche market).
- These four areas can be shown on Porter's strategic matrix.

Figure 2: Porter's strategic matrix

Cost leadership – a business aims to become the lowest cost producer. This may be achieved by a range of methods e.g. economies of scale, best technology, increased productivity, more skilled workers etc. This enables the business to achieve a competitive advantage from either lower prices and increased sales or higher profit margins.

Differentiation – a business aims to produce something that is sufficiently different or even unique compared to the competition. This attracts consumers and a competitive advantage is gained, enabling the business to charge higher prices and achieve higher profit margins.

Market segments

Cost focus & Differentiation focus – In this case the business targets a particular segment or segments within the market and focuses its strategy on satisfying their needs. These are usually regarded as niche markets. With cost focus a business will concentrate on cost and ultimately price, whereas with differentiation focus, the emphasis is on the distinctive nature of the product.

Examples
Ryanair concentrates on cost leadership.

Apple achieves brilliant differentiation, at least in the short run.

Rolls Royce fits neatly with the differentiation focus.

Many small businesses succeed with a cost focus, e.g. small bed and breakfast businesses, art film producers, microbreweries.

Using Porter

Try this
Where in the matrix would you place McDonald's, Coca-Cola, Premier Inn, your hairdresser, Sainsburys and Jo Malone's perfumes? When you have decided, compare your answers with someone else's and discuss why they differ (if they do).

Aim of portfolio analysis

Revise
The product life cycle, the product portfolio and the Boston Matrix were covered in Theme 1. Be sure to revise the diagrams carefully. (Revision Guide to AS Business pages 33-35.)

The **product portfolio** is the whole range of products and brands that a business sells. It can provide diversified sources of income, maybe in different markets but also within one market where several differentiated products will sell.

Differentiation

Businesses can:

- Analyse and compare the profitability of each product in their portfolio.
- Assess the market positioning of the product and whether it might be altered to attract a larger market.
- Assess the product features to decide whether redesigning would differentiate them more effectively from competing products.
- Undertake market research which will highlight any need for change.
- Ensure that they have products in different phases of the product life cycle.
- Use the Boston Matrix to identify strategies for the future.

Portfolio analysis is the appraisal of the product portfolio to determine the relative worth of each item in the range and its contribution to the business. Two common measures used in portfolio analysis are market growth rate and relative market share.

The Boston Matrix

The Boston Matrix places products in four categories according to their market share and market growth. Each category will require a different marketing mix. An awareness of where each product is placed on the matrix can help with planning marketing strategies.

- A balanced portfolio is needed. Both stars and problem children have potential as their market is expanding, but they need to be promoted and protected.
- The product life cycle shows that cash cows will eventually fade away. So stars and problem children need to be nurtured in order to become cash cows of the future.

It is a useful method of looking at a portfolio, **But…**

- It is only a snapshot of the current position.
- It has little or no predictive value.
- High market growth does not necessarily mean the market is an attractive one.
- High market share is not necessarily a good measure of a product's ability to generate cash.
- Focusing on market growth and market share ignores other issues such as developing a sustainable competitive advantage.

Costs and prices

These considerations may point towards the importance of reviewing pricing strategies and production costs when planning new strategies.

Achieving competitive advantage through distinctive capabilities

John Kay, a well-known business economist, sees distinctive capabilities as being built around three key ideas:

Architecture

- Architecture, which relates to managerial skills that facilitate good relationships with employees, customers and suppliers.

Reputation

- Reputation, which relates to product quality, customer service, value for money and reliability. Technical and managerial skills will contribute. Brands may identify these advantages.

Innovation

- Innovation – meaning the capacity of the business to relate to customers and provide new and improved products. Technical skills and market orientation will be important.

Kay stressed the fact that each individual business is likely to have its own particular advantages.

Building the right kind of portfolio depends on having **distinctive capabilities** with potential for creating a **competitive advantage**.

> **Competitive advantage** is any feature of a business that enables it to compete effectively. It may be based on price, quality, service, reputation or innovation.
>
> **Distinctive capabilities** are the ideas, resources and capabilities that a business possesses that are better than those of its competitors and cannot easily be copied.

- A competitive advantage means that the business can create greater value for its customers and thus higher profits for itself.
- The goal of much business strategy is therefore to achieve a competitive advantage that is sustainable for as long as possible.
- **The more distinctive capabilities a business has, the more likely it is to create a competitive advantage and to make it last.**

Example

BP says: "We apply advanced technology across the value chain, from finding resources to developing energy-efficient and high-performance products for customers. We work to develop and maintain strong relationships – with governments, partners, civil society and others – to enhance our operations in more than 70 countries."

Distinctive capabilities

Distinctive capabilities

Resources are the assets useful for creating a cost or differentiation advantage that few competitors can easily acquire.	**Qualities** are the particular characteristics of the business that enable it to make effective use of its resources.
• Brand names and brand image.	• A strong corporate culture.
• Innovative products or services.	• Efficient logistical systems.
• Reputation.	• Good customer relations.
• Technologies, skills and knowledge.	• Effective management.
• Customer loyalty.	• Teamwork and good communication.
• Patents and trademarks.	• Flexibility and willingness to adapt.

Effect of strategic and tactical decisions on human, physical and financial resources

"Tactics may achieve goals. Strategy is all about setting the right goals."
Lynn Parker, Startup Strategies

Strategic decisions are made in order to meet the objectives of the business. They are usually long term in nature. For example, should we enter a new market?

Tactical decisions are the shorter term steps taken to help achieve the strategy. For example, what price should we charge? Or, should we focus on increasing advertising in the run-up to Christmas?

- Both types of decision will have an impact on the human, physical and financial resources of the business.
- Strategic decisions are likely to place greater demands on resources than tactical ones simply because they are bigger in scope and longer lasting.
- Making good decisions means being as well-informed as possible about the impact they are likely to have.

Developing resources

Human Resources	Physical Resources	Financial Resources
The business will have to make sure it has enough people with the right skills and qualities needed to implement the decisions	The business will have to make sure it has the capacity and equipment that will be needed to implement the decisions	The business will need to ensure that it has sufficient finance to provide both investment and working capital to fulfil its plans

3.1.3 SWOT analysis

SWOT is an acronym that stands for:

Strengths, Weaknesses, Opportunities, Threats = SWOT

SWOT analysis is a simple framework which enables managers to think more clearly about the business and its potential options.

It identifies internal and external factors that will affect the business in both positive and negative ways.

SWOT

Internal factors	External factors
Strengths – things that the business does well or possesses – e.g. market share, amount of finance, skilled workforce, brand name, patents, customer loyalty.	**Opportunities** – areas that the business could take advantage of in the future – e.g. emerging markets, new technology, development of new market segments, a rival experiencing problems.
Weaknesses – things that could cause problems if they are not addressed – e.g. poor brand image, ineffective management, cash flow problems, declining market share.	**Threats** – areas that are likely to have a negative impact on the business – e.g. the actions of competitors, government intervention in the market/economy, changes in consumer preferences.

Try this

Do a SWOT analysis on BP. How might this have benefited BP if it had been done before the Deepwater Horizon episode in 2010? Next, think about a small business that you know about. Imagine it, going through the SWOT process. What conclusion might it come to?

3.1.4 Impact of external influences

PESTLE analysis

PESTLE is another analytical tool that is designed to make a business think more carefully about what is happening *outside* the business that is likely to have an impact *inside* the business.

Adapting to change

By considering each of these areas a business can formulate appropriate strategies.

PESTLE stands for…

Political, Economic, Social, Technical, Legal and Environmental

Political	The actions of governments both at home and abroad, the degree and extent of government intervention on the business.
Economic	Variables such as the level of unemployment, the rate of inflation, the stage of the business cycle, interest rates and exchange rates.
Social	Demographic changes, changing attitudes to race, religion and sexuality, changes in lifestyles, changes in attitudes to the environment, rise of the knowledge economy.
Technical	New inventions, changes in information and mobile technology, changes in internet and e-commerce, new methods of manufacture, distribution and logistics.
Legal	All the laws, rules and regulations that a business needs to comply with, existing legal requirements and planned ones.
Environmental	Growing awareness of the need to conserve limited natural resources and to follow sustainable practices. Waste disposal and recycling procedures.

Although PESTLE is split into six headings they often intertwine and cross boundaries. For example the UK's decision to leave the EU will almost certainly affect all six areas.

A business that fails to monitor changes in the competitive environment and take action runs the risk of losing market share or even failure.

The changing competitive environment

The competitive environment or market structure involves all the external factors that either compete with or have an impact on a business.

New technologies

It is constantly changing, it is dynamic and a business that fails to monitor these changes and take action runs the risk of losing market share or even failure.

Direct competitors – Businesses are likely to have direct rivals who produce very similar products and services, Domino competes directly with Papa John's, Nationwide with Halifax, Asda with Tesco and so on. They are competing for the same consumer and will try to find more effective ways of competing.

Changing preferences

Indirect competitors – are not direct rivals but they are competing for the same consumer spending power. If a consumer buys a new fitted kitchen they may have decided not to buy a new car. The kitchen provider and the car showroom are in indirect competition for that consumer's spending power.

Think!
Distinctive capabilities can help businesses to cope with change in a dynamic and competitive environment. Identify key features of a competitive environment and consider how distinctive capabilities of the sort described on pages 7-8 could help to address the process of adapting to change.

Porter's five forces

Michael Porter formed the idea that there were five forces that determined where power lay in any given market. With his five forces, he attempts to look at how these constantly changing influences affect a business and where the power in any particular situation lies.

- Examining how the five forces impact upon a business, it becomes possible to understand both the strength of its current competitive position, and the strength of a position it might be considering moving into.
- Once a business knows where its power lies, it can exploit a situation of strength, improve a situation of weakness, and avoid mistakes. It can help the business decide whether new products or services have the potential to be profitable.

- Understanding this enables a business to assess its current position and possible options as well as helping to decide whether new products or services have the potential to be profitable. The conclusions should help the business to maintain its competitive advantage.

Five forces

The five forces:

Rivalry amongst existing competitors	• The more competitors that there are, the more competitive the market is and the less influence each business has over its rivals. • Markets that have only a few competing firms are much less competitive and each individual business has much more control.
The threat of new entrants	• If it is easy for new businesses to enter the market then competition is likely to be greater. • Barriers to entry make it harder for new businesses to compete and reduce the competition in the market. Economies of scale, brand loyalties and technical superiority are all potential barriers to entry.
The threat of substitute products	• Similar products are likely to face more competition because in the mind of the consumer there is little to choose between them. • This restricts the power of the individual business to raise price and so it has less influence over the market.
The bargaining power of suppliers	• If there are many suppliers, the business has more choice as to which one to use. This gives the business more power. • If there are a limited number of suppliers (or even just one) then the power lies with the supplier.
The bargaining power of buyers	• If there are only a few buyers they have much greater power and control over the prices they are prepared to pay. • When there are many buyers the opposite is true.

Porter's five forces can be used to investigate the intensity of competition within an industry. They can help a business to analyse the competitive forces that it faces and so to devise an effective strategy for achieving a competitive advantage and greater profitability.

Example

Existing businesses can deter new entrants by extensive advertising. The two detergent giants, Unilever (Persil), and Procter and Gamble (Ariel and Fairy), spend huge sums on advertising. Potential competitors would find it very hard to finance sufficient advertising to make consumers aware of their existence.